

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re

NORTEL NETWORKS INC., *et al.*,

Debtors.

Chapter 11

Case No. 09-10138 (KG)

(Jointly Administered)

- and -

Court File No.: 09-CL-7950

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. c-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED,
NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS
INTERNATIONAL CORPORATION and NORTEL NETWORKS
TECHNOLOGY CORPORATION

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

**JOINT ADMINISTRATORS' PREHEARING BRIEF REGARDING
ALLOCATION OF THE PROCEEDS OF THE NORTEL ASSET SALES**

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I. INTRODUCTION

1. The EMEA Debtors' position is simple and even-handed: Each party's share of the Nortel asset sales proceeds should be determined according to its relative contributions to creating the value of what was sold. This is the only approach to allocation that is consistent with (i) the way the Nortel companies allocated the fruits of their business prior to the insolvency filings, (ii) the rights of the parties, and (iii) fundamental principles of justice and fairness.

2. The issue for the Courts to determine is how to allocate the approximately \$7.3 billion in proceeds from the sales of Nortel's global businesses (the "Business Sales") and pool of residual patents (the "Residual Patent Sale") among the three estates: the U.S. Debtors,¹ the Canadian Debtors,² and the EMEA Debtors.³ To address this question, it is first necessary to identify what classes of assets were conveyed in each of the sales, because the rights of the parties differ in relation to each class of assets. The largest portion of the proceeds from the Business Sales and the Residual Patent Sale is attributable to the value of Nortel's intellectual property ("IP"), which had been the main economic driver of Nortel's business. The biggest issue in the case is

¹ The "U.S. Debtors" are: Nortel Networks Inc.; Nortel Networks Capital Corporation; Nortel Altsystems Inc.; Nortel Altsystems International Inc.; Xros, Inc.; Sonoma Systems; Qtera Corporation; CoreTek, Inc.; Nortel Networks Applications Management Solutions Inc.; Nortel Networks Optical Components Inc.; Nortel Networks HPOCS Inc.; Architel Systems (U.S.) Corporation; Nortel Networks International Inc.; Northern Telecom International Inc.; Nortel Networks Cable Solutions Inc.; and Nortel Networks (CALA) Inc.

² The "Canadian Debtors" are: Nortel Networks Corporation; Nortel Networks Limited; Nortel Networks Technology Corporation; Nortel Networks Global Corporation; and Nortel Networks International Corporation.

³ The "EMEA Debtors" are: Nortel Networks UK Limited; Nortel GmbH; Nortel Networks (Austria) GmbH; Nortel Networks (Ireland) Limited; Nortel Networks AB; Nortel Networks B.V.; Nortel Networks Engineering Service Kft; Nortel Networks France S.A.S.; Nortel Networks Hispania, S.A.; Nortel Networks International Finance & Holding B.V.; Nortel Networks N.V.; Nortel Networks Oy; Nortel Networks Polska Sp. z.o.o.; Nortel Networks Portugal S.A.; Nortel Networks Romania SRL; Nortel Networks S.A.; Nortel Networks S.p.A.; Nortel Networks Slovensko, s.r.o.; and Nortel Networks, s.r.o.

therefore how to allocate the asset sale proceeds attributable to IP. The three estates argue for very different approaches:

**A. The EMEA Debtors:
Allocation Of IP Value Should Be Based On
Relative Contributions To The Creation Of The IP.**

3. The IP that was conveyed in the Business Sales and the Residual Patent Sale was the product of collaborative joint research and development (“R&D”) efforts by each of the five Nortel residual profit split (“RPS”) entities, *i.e.*, Nortel Networks Limited (“NNL”), Nortel Networks, Inc. (“NNI”), Nortel Networks UK Limited (“NNUK”), Nortel Networks S.A. (“NNSA”), and Nortel Networks (Ireland) Limited (“NN Ireland”). Each of these companies spent billions of dollars on R&D. The product of this R&D was a large portfolio of valuable technology in which the contributions of the individual RPS entities were integrated and indivisible. Prior to insolvency, Nortel allocated the fruits of exploitation of the jointly created IP based on the relative financial contributions of the Nortel entities to the creation of that IP. The EMEA Debtors contend that the fruits of the sale of Nortel’s IP should be allocated among the estates using the same approach.

4. The contribution approach is the right way to allocate the proceeds attributable to the value of the jointly created IP because it is the only approach that is consistent with the pre-existing rights of the parties, as confirmed by how the parties themselves always behaved:

- It is consistent with the way in which the Nortel companies historically shared the proceeds of all manners of exploitation of the IP, including profits and losses from sales of products incorporating Nortel IP, proceeds from sales of IP, payments received from third parties who licensed the IP from Nortel, and payments from third parties who infringed Nortel’s IP;
- It is consistent with what Nortel executives understood the rights of the parties to be and how they described those rights;

- It is consistent with the agreements between the parties, which recognized that the five RPS entities bore “the full entrepreneurial risks and benefits for the Nortel Networks business” and that each of them therefore “should benefit from its contribution to R&D activity commensurate with the value of its contribution to that R&D activity”;⁴
- It is consistent with what Nortel told tax authorities in the United States, Canada, and EMEA⁵ about the rights and economic interests of the parties in the IP;
- It is consistent with how Nortel allocated the proceeds from the only material prepetition sale – the sale of the UMTS business to Alcatel in 2006;
- It is consistent with Nortel’s 2006 conclusion that it did not need to write down the value of its investment in its French subsidiary, NNSA, because NNSA “own[ed]” about 10% of the \$6–\$8 billion worth of Nortel technology;
- It is consistent with Nortel’s conclusion, when valuing certain subsidiaries in 2007, that the value of the Group’s IP “is apportioned across the Group” in relation to each entity’s contribution to the creation of IP and that “beneficial ownership is shared” by the parties;
- It is consistent with how Nortel allocated payments received from parties who infringed Nortel’s patents;
- It is consistent with how NNL proposed to share the proceeds of a contemplated sale of the Enterprise business in preparing for bankruptcy;
- It is consistent with how the Canadian Monitor accounted in NNL’s financial statements for the proceeds from the postpetition sales that are the subject of this matter;
- It is required by the arm’s length principle, a universally accepted, objective test for allocating the value generated by a multinational group among group companies; and
- It is consistent with beneficial and economic ownership rights that arise by operation of law where multiple parties have jointly created and contributed to an intangible asset such as IP.

⁴ Master R&D Agreement as between NNL, NNI, NNUK, NNSA, NN Australia, and NN Ireland, at 1–2 (Dec. 22, 2004), at NNC-NNL06001514/1–2 (Ex. TR21003).

⁵ Europe, the Middle East, and Africa.

5. In their prepetition arrangements, the parties have themselves already created an objective formula for how to allocate the value of Nortel's IP based on their respective contributions to the creation of that value: Because of the integrated and additive nature of R&D at Nortel, and the indivisible character of the IP portfolio that was the product of that R&D, the parties agreed that every dollar spent on R&D by any Nortel party had the same value as any other dollar. The parties therefore agreed that the value of IP should be allocated based on their relative R&D spending during the period when a particular commercially exploitable technology was developed, *i.e.*, during the useful (or economic) life of the IP. Accordingly, the task for the Courts in allocating IP value is to determine (i) the value of the IP transferred to the purchaser in each of the asset sales, and (ii) the relative R&D spending of each of the five RPS entities during the period when that IP was developed. This was the approach taken by Nortel in allocating the proceeds of the one major prepetition asset sale, and it is the approach that would have been taken if the Business Sales or the Residual Patent Sale had taken place prior to the insolvency filings.

**B. The Canadian Debtors:
NNL Should Get The Proceeds From The
Sale of Jointly Created IP As Holder Of Legal Title.**

6. The Canadian Debtors assert that they are entitled to over 90% of the sale proceeds attributable to IP, including 100% of the \$4.5 billion received in the Residual Patent Sale,⁶ because NNL, as the entity that administered Nortel's IP portfolio, had received assignments of

⁶ Rebuttal Report of Philip Green Regarding the Allocation of Recoveries Among Nortel Entities 44 (Feb. 28, 2014) (allocating to the Canadian Debtors \$1,379,850,000 out of \$1,982,250,000 on account of Business Sale proceeds attributable to IP rights and customer relationships, and allocating to the Canadian Debtors \$4,453,350,000 out of \$4,453,350,000 on account of the Residual Patent Sale proceeds).

legal title for all of Nortel's patents. Nortel's patents were initially filed on behalf of individual inventors who worked in the labs of each of the RPS entities around the world. Pursuant to the agreements under which the RPS entities collaborated in the joint creation and exploitation of Nortel's IP, legal title to patents held by any Nortel inventor would ultimately be assigned to NNL, regardless of who actually invented the technology or employed the inventor. Nortel personnel have confirmed that this was done for administrative convenience only. It was not intended to and did not divest the RPS entities of their beneficial and economic ownership rights in Nortel IP.

7. The Canadian Debtors' extreme and opportunistic theory ignores the agreement of the parties to share profits, the representations made to the tax authorities and stakeholders, and the rights of other Nortel entities around the world that contributed billions of dollars to the creation of the IP, for which they received nothing during Nortel's life but (i) a greater share of operating losses, and (ii) licenses that the Canadian Debtors now maintain have negligible or no value. According to the Canadian Debtors' theory, no entity but NNL has any ownership interest whatsoever in the jointly created IP. NNL served as the administrator of all of the Nortel Group's IP – a function that for practical and IP enforcement reasons needed to be handled by one entity. The parties transferred legal title (and explicitly only legal title) to NNL so it could perform these functions, but this no more affected the parties' beneficial rights (and economic entitlements) than does the transfer of legal title in securities to a depository corporation.

8. The Canadian Debtors' position produces grossly unfair results because it is inconsistent with the manner in which Nortel operated and contrary to the rights and interests of the Nortel entities in the IP. All five RPS entities held, and were always treated as holding, both economic and beneficial ownership in Nortel's IP. At no time did Nortel operate in a manner that

supported the theory that NNL was the only party with an interest in the IP, entitled to the IP or the fruits that came from the creation of the IP. At no time did the RPS entities other than NNL agree to give up their valuable rights to the jointly created IP. Indeed, John Doolittle (a senior Nortel Canada executive for twenty years and NNL's postpetition CFO) has stated that the Canadian estate's position is "not consistent with my understanding of the way the company operated."⁷

9. Nor is the Canadian Debtors' position permissible under the international tax regime followed in the United States, Canada, the United Kingdom, and all other relevant countries, which requires adherence to the "arm's length" principle. Under that principle, the parties were entitled to arm's length compensation for any value they contributed to another company in the group. Had the parties transferred their beneficial ownership of Nortel's IP to NNL and given NNL the right to sell the IP and retain 100% of the proceeds, as the Canadian Debtors assert, this would have represented a massive transfer of value to NNL. That no such compensation was ever recorded shows that no such transfer ever took place.

10. With respect to the Business Sales, the Canadian Debtors acknowledge that they are not entitled to receive 100% of the approximately \$3 billion in proceeds. Although they again ignore the beneficial interest of the other four RPS entities in the proceeds attributable to IP, they acknowledge that these parties are at least entitled to receive some value for the license rights they relinquished to facilitate each sale. But the Canadian Debtors adopt an unduly restrictive interpretation of these licenses that misconstrues their nature, effect, scope, meaning, value, and

⁷ J. Doolittle Tr. 149:24–150:14, Dec. 5, 2013.

significance. This is done in an attempt to demonstrate that substantially all the value of the Business Sales should go to the Canadian Debtors. Even on its own terms, however, the Canadian Debtors' theory misconstrues or ignores key provisions of the relevant agreements and the record of the parties' conduct, and also ignores the fact that much of the value realized in the Business Sales was attributable to valuable customer relationships that belonged exclusively to the EMEA and U.S. Debtors.

**C. The U.S. Debtors:
Each Of The RPS Entities Is Entitled To
The Value Of The License Rights It Relinquished.**

11. The U.S. Debtors argue that the proceeds of the sales of Nortel's IP should be shared based on the value of the licensing rights that each party relinquished in each of the asset sales. The U.S. and the three EMEA RPS entities enjoyed exclusive license rights in their respective territories, and the Canadian company, NNL, had exclusive rights in the Canadian market. As the United States was the world's most lucrative market for Nortel products, the U.S. Debtors claim that NNI's exclusive U.S. license entitles it to the lion's share of the proceeds, not just from IP but from all classes of assets.

12. Pursuant to their arrangements for co-developing Nortel's IP, the RPS entities agreed that: (i) each of the five RPS entities would receive a proportional share of the profits from the commercial exploitation of Nortel IP everywhere in the world, based on its relative contribution, (ii) legal title to patents and other inventions created by the four RPS entities other than NNL would be assigned to NNL, and (iii) each of the four RPS entities other than NNL would have an exclusive license to exploit Nortel's technology in its geographic area and nonexclusive rights in the rest of the world.

13. The EMEA Debtors believe that the fundamental aspect of the R&D arrangements that is determinative of the present dispute is the right of each RPS entity (including NNL) to a share of the profits from exploiting Nortel's IP according to its proportional contributions to the creation of the IP (*i.e.*, the profit sharing agreement). Prior to their insolvency proceedings, the parties themselves used a profit sharing arrangement based on relative R&D spending to govern the division of profits and losses that came from Nortel's IP, without regard to licensing rights or legal title. However, the U.S. Debtors correctly point out that the right to exploit the IP in their various home markets was a valuable right that each of the four RPS entities surrendered to facilitate each of the asset sales. Thus, although the EMEA Debtors believe that their contribution approach produces the most appropriate allocation because it most closely follows the economic rights of the parties and their historical approach to dividing IP profits, an approach based on valuing the licenses is, unlike the Canadian Debtors' approach, at least grounded in the actual substantive rights of the parties.

14. However, the U.S. Debtors have not properly valued the license rights surrendered by the parties. In particular, while the U.S. Debtors acknowledge that the value relinquished for the nonexclusive territories was equal for the five RPS entities, they artificially depress the value of the nonexclusive licenses by discounting, mostly to zero, the valuable nonexclusive license rights that NNI, NNUK, NNSA, and NN Ireland enjoyed in China and the rest of the world. The U.S. Debtors also incorrectly allocate proceeds from the sale of tangible, customer, and goodwill assets according to license rights that only applied to IP.

15. The Canadian Debtors' alternative approach to valuing the license right is based on an incorrect reading of the scope of the license rights and a refusal to share the premium that the

purchasers paid on top of the value the Nortel entities themselves might have earned had they continued in business.

16. The EMEA Debtors' primary position is that the contribution approach should be adopted by the Courts. But if the Courts were to adopt the license approach, the errors in the other parties' approaches should be corrected in the manner set forth in the EMEA Debtors' expert reports.⁸ As so corrected, the license approach is a reasonable alternative approach to allocation.

D. Allocation Of Proceeds Attributable To Net Tangible Assets, Customers, And Goodwill

17. Allocation of IP value is the most consequential issue in the case because it addresses how to allocate the \$4.5 billion received in the Residual Patent Sale. However, proceeds attributable to other classes of assets made up a substantial portion of what was received in each of the Business Sales.

18. In addition to IP, Nortel sold several other classes of assets in the Business Sales: net tangible assets, customer-related assets, and goodwill. Net tangible assets represents a composite asset class consisting of monetary assets, inventory, and fixed assets sold to the purchasers, netted against liabilities of the Nortel businesses that were assumed by the purchasers. The fair market value of net tangible assets is the book value of these assets. The EMEA Debtors submit that this value should be allocated directly to the Nortel debtors that carried those assets on their balance sheets.

⁸ See Rebuttal Report of James E. Malackowski 5–6, 18–22 (Mar. 24, 2014) [hereinafter “Malackowski Rebuttal”]; Expert Report of Paul P. Huffard in Rebuttal to Canadian and U.S. Expert Reports ¶¶ 7–9, 18–38, 76–77 (Feb. 28, 2014) [hereinafter “Huffard Rebuttal”].

19. Customer-related assets represents another composite asset class comprised of customer relationships as well as Nortel's sales, distribution, and customer-support infrastructures. Goodwill not associated with IP is the residual value the purchasers received in excess of the value of the other asset classes (IP, net tangible assets, and customer-related assets) that were purchased. As the value of both customer-related assets and goodwill depends on revenue from customers, and customer-related assets cannot be valued independently, these assets are grouped together and form a residual category representing the premium on the sale price paid by the purchasers to acquire these valuable intangible assets in addition to Nortel's IP.

20. There is ample evidence in the record that Nortel and the purchasers recognized that one of the key value drivers in the Business Sales was existing customer relationships maintained throughout North America and EMEA, which the purchasers hoped to capitalize upon once the businesses were acquired. The value of customer-related assets and goodwill not associated with IP comprises the remainder of the proceeds from each Business Sale after subtracting the value of net tangible assets and IP. This residual value represents the future cash flows beyond what could be generated by the net tangible assets and IP and is best allocated based on the historical revenue attributable to each Nortel debtor.

E. The Allocation That Results From Each Approach

21. The following is a summary of how the total proceeds of the asset sales would be allocated under the approaches advocated by the EMEA Debtors, the Canadian Debtors, and the U.S. Debtors:

PERCENTAGE ALLOCATION OF ASSET SALE PROCEEDS BY APPROACH			
	To EMEA	To Canada	To U.S.
EMEA (Contribution Approach)	18.2%	31.8%	50.0%
Canada (Legal Title Approach)	4.1%	82.2%	13.7%
U.S. (License Approach)	16.8%	10.6%	72.6%

II. BACKGROUND

22. The following sections summarize the key facts and events relevant to determining how the proceeds of the Nortel asset sales should be divided among the parties:

A. Overview Of The Nortel Group

23. The Nortel Group was a global supplier of end-to-end networking products and solutions serving telecommunications carriers, service providers, enterprises, governments, and other users.⁹ Nortel Networks Corporation (“NNC”) was the publicly traded Canadian parent of the Nortel Group.¹⁰ NNL, a subsidiary of NNC, was the primary Canadian operating company and also functioned as the holding company for most of the other companies in the Nortel Group.¹¹ Collectively, NNC or NNL owned (either directly or indirectly) 100% of the equity of NNI, the main U.S. operating subsidiary, along with NNUK, NNSA, NN Ireland, and the other Nortel subsidiaries in the EMEA region.¹²

24. During the final decade of the Nortel Group’s existence, five companies in the Group were the economic and commercial engines of the business: NNI, NNL, NNUK, NNSA, and

⁹ NNC Annual Report for the Year Ended Dec. 31, 2007 (Form 10-K), at 1 (Feb. 27, 2008) (Ex. TR40976).

¹⁰ NNC Annual Report for the Year Ended Dec. 31, 2007 (Form 10-K), at 1 (Feb. 27, 2008) (Ex. TR40976).

¹¹ Affidavit of John Doolittle ¶¶ 21(b), 26, Jan. 14, 2009 (Ex. TR21539) [hereinafter “Doolittle Aff.”].

¹² Doolittle Aff. ¶¶ 21(a), 21(b), 23, 26 (Ex. TR21539).

NN Ireland.¹³ These were integrated companies that participated in and managed all key aspects of the Nortel business, including the R&D that led to the creation of Nortel’s technology, as well as sales, marketing, and distribution of Nortel products to customers.¹⁴ Pursuant to the financial arrangements followed by Nortel from 2001 onward (described in more detail below), these five companies were considered the entrepreneurs of the Nortel Group, sharing in the profits and losses of the Group.¹⁵ For this reason, they are referred to as residual profit split (RPS) entities.

25. In addition to the five RPS entities, the Nortel Group included many other companies that performed narrow functions or fulfilled particular roles, such as the distribution, sales, and marketing of Nortel products within particular geographic areas.¹⁶

26. Although Nortel was founded in Canada and had been one of the leading Canadian telecommunications companies for most of its existence, by 2001 it had – through growth and international acquisitions – become a multinational enterprise for which non-Canadian activity was far more important than activity in Canada.¹⁷ The most important markets for Nortel products were outside Canada. In 2008, the U.S. region accounted for 42.5% of Nortel’s

¹³ NNL and NNI Joint Request for U.S.–Canada Bilateral Advance Pricing Agreement/Arrangement 2007–2011 (with rollback to 2006), at 11–12 (Oct. 31, 2008) (Ex. TR22078) [hereinafter “NNL-NNI Joint APA Request”].

¹⁴ NNL-NNI Joint APA Request at 11–12 (Ex. TR22078).

¹⁵ Nortel Networks Functional Analysis for the Years Ended Dec. 31, 2000–2004, at 93–95 (Nov. 30, 2004) (Ex. TR21407) [hereinafter “Functional Analysis”].

¹⁶ See NNL-NNI Joint APA Request at 12 (Ex. TR22078). These entities included Limited Risk Entities (“LREs”) and Cost Plus Entities (“CPEs”), depending on the nature of their financial arrangements with the Nortel Group. A final category included the At Risk Entities (“AREs”), which were former joint ventures that conducted some R&D and therefore had a broader role than the LREs or CPEs. See Expert Report of Paul P. Huffard, app. 7, at 3–4 (Apr. 11, 2014) [hereinafter “Huffard Report”].

¹⁷ See NNUK Administrators’ Statement of Proposals, at 3 (Feb. 2009) (Ex. TR31623); NNC Annual Report for the Year Ended Dec. 31, 2001 (Form 10-K), at 1, 6–7, 10–11, 13–14 (Mar. 11, 2002) (Ex. TR46952).

revenues, while the EMEA region contributed 23.2%, and Canada only 6.7%.¹⁸ The R&D function, which was the source of Nortel’s ability to develop commercially successful products, extended well beyond Canada. From 2001 onward, the Nortel Group’s principal research facilities were spread across Canada, the United States, England, France, and Ireland, with each research facility operated by the Nortel company in whose area it was found.¹⁹

27. Although the five RPS entities were the most important companies in the Nortel Group, the Group’s activities were not organized primarily along corporate lines.²⁰ For at least a decade before the insolvency filings, Nortel operated as a “matrix organization,” in which key functions were coordinated across the different companies in order to serve the global R&D, manufacturing, sales, and marketing needs for each category of products or services offered globally by the Group, referred to as “Lines of Business.”²¹ Nortel’s actual operations were organized primarily around the Lines of Business,²² each of which had its own global officers and each of which was supported by employees in various functional groups (such as R&D, finance, legal, and other administrative departments) operating across corporate and national

¹⁸ NNC Annual Report for the Year Ended Dec. 31, 2008 (Form 10-K), at 54 (Mar. 2, 2009) (Ex. TR40945) (with the rest of the revenue in 2008 coming from the Asia (22.1%) and CALA (6.6%) regions; percentages do not sum to 100% due to rounding).

¹⁹ Functional Analysis at 21–22 (Ex. TR21407).

²⁰ Affidavit of Peter Currie ¶ 21, Apr. 11, 2014 [hereinafter “Currie Aff.”].

²¹ Currie Aff. ¶¶ 21–24.

²² Currie Aff. ¶ 28.

boundaries.²³ Thus, “the assets, contracts and employees relevant to the operation of a particular [Line of Business] were owned or employed by various individual Nortel legal entities.”²⁴

B. Nortel’s Insolvency Proceedings

28. During the fall of 2008, the worldwide economic downturn put increasing pressure on Nortel’s already tenuous financial condition.²⁵ On September 17, 2008, Nortel announced it would explore a divestiture of its Metro Ethernet Networks business segment.²⁶ In the fourth quarter of 2008, Nortel internally developed a plan (“Project Copperhead”) for potential insolvency filings.²⁷ Ultimately, the company decided it was necessary to implement these plans, and on January 14, 2009 the Canadian, U.S., and EMEA Debtors filed for protection from creditors in their respective jurisdictions.²⁸

C. The Business Sales

29. Although the Nortel debtors explored a number of restructuring options during the early months of their insolvency proceedings, they ultimately decided to sell off the Group’s businesses and assets. To that end, on June 9, 2009, various Nortel entities entered into the Interim Funding and Settlement Agreement (the “IFSA”), in which they agreed to cooperate in quickly selling the Group’s worldwide assets in order to maximize sale proceeds for the benefit

²³ Currie Aff. ¶¶ 27, 31, 47–50.

²⁴ Reply Affidavit of Sharon Hamilton ¶ 16, Apr. 25, 2014 [hereinafter “Hamilton Reply Aff.”].

²⁵ See NNC Annual Report for the Year Ended Dec. 31, 2008 (Form 10-K), at 1–2 (Mar. 2, 2009) (Ex. TR40945).

²⁶ NNC Quarterly Report for the Quarterly Period Ended Sept. 30, 2008 (Form 10-Q), at 57 (Nov. 10, 2008) (Ex. TR40225).

²⁷ P. Binning Tr. 60:15–21, 61:22–62:7, Oct. 24, 2013.

²⁸ NNC Annual Report for the Year Ended Dec. 31, 2008 (Form 10-K), at 2 (Mar. 2, 2009) (Ex. TR40976).

of creditors, while deferring the issue of how the sale proceeds should be allocated among the selling entities.²⁹ The sale proceeds were to be placed into escrow pending an agreement between the parties about how to allocate the proceeds or, failing such agreement, resolution of any dispute over allocation – *i.e.*, the current dispute.³⁰ Among other things, the U.S. and EMEA Debtors agreed to terminate their license rights in Nortel’s IP in order to facilitate the sale of Nortel’s assets “and in consideration of a right to an allocation” of the sale proceeds.³¹ The IFSA, however, also gave each of the Nortel debtors the right to refuse to proceed with any sale transaction if the debtor believed in good faith that such a sale would not be in the best interests of its creditors.³²

30. Between March 2009 and March 2011, the Nortel debtors, acting under the supervision of the Courts, cooperated in successful sales of each of their eight Lines of Business, generating total proceeds of over \$3 billion (*i.e.*, the Business Sales).

D. The Residual Patent Sale

31. A significant portion of the assets sold in each of the Business Sales consisted of the IP associated with the particular Line of Business, primarily patents and associated know-how. However, (i) some of Nortel’s IP was used by more than one Line of Business, and (ii) much of Nortel’s patent portfolio was not associated with any of the Lines of Business.

²⁹ Interim Funding and Settlement Agreement as between the Canadian Debtors, U.S. Debtors, and EMEA Debtors (June 9, 2009) (Ex. TR21638) [hereinafter “IFSA”].

³⁰ IFSA § 12(b) (Ex. TR21638).

³¹ IFSA § 11(a) (Ex. TR21638).

³² IFSA § 12(e) (Ex. TR21638).

32. To determine which Nortel patents should be included in each Business Sale, Nortel evaluated each patent in its portfolio to determine its relevance to the Line of Business being sold.³³ If a patent’s “predominant use” was in a particular Line of Business, it would be sold with the assets of that business.³⁴ Any patent used in a business, but not predominantly used, would be retained by Nortel and licensed on a nonexclusive basis to the buyer.³⁵

33. Accordingly, after the Lines of Business had been sold, Nortel was left with a “residual” patent portfolio consisting of patents that were either not used in any Line of Business, or used across multiple businesses and licensed on a nonexclusive basis to one or more buyers of the Lines of Business.³⁶ A total of 7,057 patents and patent applications remained in the residual patent portfolio following the Business Sales.³⁷

³³ Nortel’s Patent Portfolio: An Overview, at 3 (July 2010) (Ex. TR43650).

³⁴ G. McColgan Tr. 123:6–132:7, Nov. 8, 2013; J. Veschi Tr. 122:6–127:10, Nov. 7, 2013.

³⁵ [REDACTED]

³⁶ Email from Gillian McColgan, IP Law Bus. & Planning Operations, NNI, to John Veschi, Chief IP Officer, NNI, et al. (Jan. 12, 2010, 12:25 p.m.) (Ex. TR22107) (attaching spreadsheet categorizing residual patents as either “Shared” or “Not Used”); *see* Overview [of Nortel Patents as Presented to Iceberg Purchasers], at NNI_ICEBERG_00196160 (Ex. TR48932) (describing patents divested in Business Sales and remaining residual patents with “[s]trict limits on licenses granted”).

³⁷ Copy of Sortable Asset List with Assignee for Rockstar (Aug. 5, 2011) (Ex. TR41471) (listing Rockstar patents); *see also* Debtors’ Motion for Orders (I)(A) Authorizing Debtors’ Entry Into the Stalking Horse Asset Sale Agreement, (B) Authorizing and Approving the Bidding Procedures and Bid Protections, (C) Approving the Notice Procedures and the Assumption and Assignment Procedures, (D) Approving the License Rejection Procedures, (E) Approving a Side Agreement, (F) Authorizing the Filing of Certain Documents Under Seal and (G) Setting a Date for the Sale Hearing and (II) Authorizing and Approving (A) the Sale of Certain Patents and Related Assets Free and Clear of All Claims and Interests, (B) the

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34. It should be noted that the patents in the Residual Patent portfolio had been filed between 1992 and 2007.³⁸ Many of the most important patents had originally been filed by inventors in EMEA laboratories.³⁹

35. The Nortel debtors considered various options for how to realize value from the residual patent portfolio. The two main options considered were (i) operating a standalone business (“IP Co.”) that would generate income from the Residual Patent portfolio through licensing, infringement litigation, and other means,⁴⁰ or (ii) selling the entire portfolio.⁴¹ The debtors ultimately decided to take the latter course.

36. Like the Business Sales, the Residual Patent Sale was conducted as an auction under Section 363 of the U.S. Bankruptcy Code.⁴² In April 2011, Nortel entered into a “stalking horse” bid with Google for \$900 million.⁴³ This bid set the stage for a public auction that took place throughout June 2011.⁴⁴ There was considerable interest from major technology players, and

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Assumption and Assignment of Certain Executory Contracts, (C) the Rejection of Certain Patent Licenses and (D) the License Non-Assignment and Non-Renewable Protections ¶¶ 8–10, Apr. 4, 2011 [D.I. 5202] (Ex. TR50184) [hereinafter “Motion for an Order Authorizing and Approving Sale of Residual Patent Portfolio”].

³⁸ See Expert Report of James E. Malackowski 41 (Mar. 24, 2014) [hereinafter “Malackowski Report”].

³⁹ See Malackowski Rebuttal 40–41.

⁴⁰ Declaration of John J. Ray III ¶¶ 49–62, Apr. 11, 2014 [hereinafter “Ray Decl.”].

⁴¹ Ray Decl. ¶ 52.

⁴² See Motion for an Order Authorizing and Approving Sale of Residual Patent Portfolio ¶¶ 2, 48 [D.I. 5202] (Ex. TR50184).

⁴³ Asset Sale Agreement by and among Google Inc., Ranger Inc., NNL, NNI, NNUK, NNIR, NNSA, et al. § 2.2.1, at GIP_Nortel_00089311 (Apr. 4, 2011) (Ex. TR43640).

⁴⁴ See Order (A) Authorizing Debtors’ Entry into the Stalking Horse Asset Sale Agreement, (B) Authorizing and Approving the Bidding Procedures and Bid Protections (C) Approving the Notice Procedures and the

(Footnote continued on next page)

bidders included not only Google, but also Intel, Apple, Ericsson, Microsoft, Blackberry, Sony, and EMC.⁴⁵ During the auction, the latter six companies formed the Rockstar Consortium (“Rockstar”), which submitted the winning bid of \$4.5 billion.⁴⁶

37. Subsequent to the Residual Patent Sale, Rockstar, headed by former Nortel employee John Veschi, has found multiple ways to exploit the patents from Nortel’s residual portfolio, for both “offensive” and “defensive” purposes.⁴⁷ Offensively, Rockstar has commenced infringement actions against Google and other “Android” wireless phone makers.⁴⁸ Defensively, the fact that Rockstar holds certain patents protects the consortium members from potential infringement litigation.⁴⁹ The consortium has also sold portions of the portfolio to individual consortium members, or to third parties such as Spherix Inc.⁵⁰

38. The results of the Business Sales and the Residual Patent Sale can be summarized as

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Assumption and Assignment Procedures, (D) Approving the License Rejection Procedures, (E) Approving a Side Agreement, (F) Authorizing the Filing of Certain Documents under Seal and (G) Setting a Date of the Sale Hearing ¶¶ 26–27, 32–33, May 2, 2011 [D.I. 5359] (Ex. TR50186); Approval and Vesting Order, Certain Patents and Other Assets, July 11, 2011 [hereinafter “Canadian Residual Patent Sale Approval Order”] (Ex. TR40928).

⁴⁵ See Seventy-First Report of the Monitor ¶ 17 (July 6, 2011) (Ex. TR45574) [hereinafter “Monitor’s Report”].

⁴⁶ Monitor’s Report ¶¶ 17, 31 (Ex. TR45574); Asset Sale Agreement by and among Rockstar Bidco, LP, NNL, NNI, NNUK, NNIR, NNSA, et al., Preamble, § 2.2.1 (June 30, 2011) (Ex. TR44220); Canadian Residual Patent Sale Approval Order (Ex. TR40928).

⁴⁷ See Joff Wild, *Star Man*, *Intellectual Asset Management* 63, 65–67 (July/Aug. 2013) (Ex. TR40775).

⁴⁸ See generally Complaint for Patent Infringement, *Rockstar Consortium US LP v. Google Inc.*, No. 2:13-cv-00893 (E.D. Tex. Oct. 31, 2013) (Ex. TR50085).

⁴⁹ Cf. J. Roese Dep. 211:21–212:3, Nov. 12, 2013; T. Collins Dep. 62:11–63:11, Nov. 15, 2013.

⁵⁰ Press Release, Spherix Inc. Spherix Acquires Over 100 Patents and Patent Applications Portfolio from Rockstar Consortium (Jan. 6, 2014) (Ex. TR50492).

follows⁵¹:

BUSINESS SALE DESCRIPTIONS				<i>\$ in millions</i>
Original Nortel Segment	Business Sales	Purchase Price ⁽¹⁾	Escrow Balance ⁽²⁾	Description
Carrier Networks	CDMA	\$ 1,120	\$ 1,053	Included 2G/3G mobility networking solutions based on CDMA channel access method; Nortel R&D efforts included innovative technologies focused on areas of 4G broadband, including LTE.
	GSM	118	106	GSM is a mobile technology providing global wireless coverage with more than 2.6 billion users worldwide. Nortel's GSM business includes GSM network access products that provide nationwide coverage and significantly increase the access to networks. GSM-R provides a secure wireless communications system for railways operators, was also based on GSM technology.
	Next Gen	10	10	Sub-unit of Nortel's broader wireless business that developed network components designed to provide data network connectivity and increase network bandwidth for multimedia content and applications.
	CVAS	159	140	Delivered both products and services principally to telecommunications services providers and multi-system operators that enable them to provide voice, data and multi-media telecommunications solutions to their end clients.
Enterprise Solutions	Enterprise	933	843	Business addressed the communication needs of large and small businesses across various industries by providing products and services that integrate voice, email, conferencing, video and instant messaging.
Global Services	Layer 4-7	18	18	Sold certain application delivery products, primarily the Nortel Application Switch and Nortel Application Accelerator products, which improve application availability, performance and security and reduce server and bandwidth needs to improve the responsiveness of web-based applications.
Metro Ethernet Networks	MEN	680	610	Delivers and services communications infrastructure and solutions for the transport of voice, video and data signals for the "Metropolitan" and "Long-Haul" communications markets using innovating optical networking capabilities
	MSS	49	46	Division of Nortel's MEN business. Delivered a high capacity, high reliability multi-service switch that can aggregate and route different kinds of traffic (data, video, voice and various other protocols) and provided related services principally to telecommunications service providers and multi-system operators.
R&D Not Attributable to Business Line	Residual IP	4,505	4,454	Nortel's extensive research and developed generated intellectual property that was not specifically attributable to its segments or not sold as part of the business sales. This included over 6,000 granted patents, patent applications and invention disclosures thought worthy of protection by patent application that were sold separately from the business sales.
Total		\$ 7,592	\$ 7,280	

(1) "Purchase Price" is defined as the escrow balance for each transaction plus (i) value distributed to Nortel entities, plus (ii) costs paid for by the purchaser unrelated to the value of the business as a whole, plus (iii) payments from the purchaser to satisfy claims against the estate and deduct (iv) escrow releases back to the purchaser.

(2) "Escrow Balance" is defined as the cash balance available for distribution for each business sale held within the escrow accounts as reported on the escrow account balance summary from NNL's Treasury dated July 25, 2013.

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39. Thus some \$7.3 billion is in escrow, awaiting distribution among the Nortel debtors.

III. OVERVIEW OF APPROACH TO ALLOCATION

40. Several classes of assets were conveyed to the purchaser in each of the Business Sales, including tangible assets,⁵² IP, customer-related assets, and goodwill.⁵³ The Residual Patent Sale consisted almost exclusively of IP.⁵⁴ Inasmuch as the entitlement of each of the Nortel debtors differs with respect to each class of assets, the proper approach to allocating proceeds requires the following steps: (i) identify the specific classes of assets that were conveyed in each Business Sale and the Residual Patent Sale, (ii) determine what portion of the purchase price in each sale is attributable to each class of assets, and (iii) determine the entitlement of each of the Nortel debtors to the proceeds attributable to each class of assets in each of the sales.⁵⁵

41. With respect to the asset classes sold in the Business Sales, the EMEA Debtors' valuation experts – James E. Malackowski, an expert in IP valuation, and Paul P. Huffard, an expert in asset valuation and restructuring – have determined the portions of each purchase price attributable to each asset class. First, Mr. Malackowski valued the IP sold in the Business Sales according to the value of the IP to the Nortel business being sold and the amount that a third party would have to pay to license the IP.⁵⁶ Mr. Huffard then deducted from the total proceeds

⁵² Tangible assets (monetary assets, inventory, and fixed assets) are netted against the liabilities of the Lines of Business that were assumed by the purchasers in connection with the Business Sales, which creates the net tangible asset class. *See infra* Section VI.

⁵³ Huffard Report ¶¶ 58–59.

⁵⁴ Huffard Report ¶ 59.

⁵⁵ *See* Huffard Report ¶ 56.

⁵⁶ Malackowski Report 20.

of the Business Sales (i) the value of the IP, as determined by Mr. Malackowski, and (ii) the value of the net tangible assets, as reflected in the books and records of each Nortel Debtor.⁵⁷ Finally, Mr. Huffard attributed the remainder of the proceeds to customer-related assets and goodwill.⁵⁸

42. The table below shows the breakdown of the purchase price across all of the asset classes sold in each of the Business Sales⁵⁹:

BUSINESS SALES BY ASSET CLASS								<i>\$ in millions</i>
Sale	Monetary Assets	Inventory	Fixed Assets	IP	Customer Related Assets & Goodwill	Business Value	Assumed Liabilities	Purchase Price
CDMA	\$ 1 0.1%	\$ 14 1.2%	\$ 4 0.3%	\$ 256 22.5%	\$ 865 75.9%	\$ 1,140 100.0%	\$ 19 1.7%	\$ 1,120 98.3%
Enterprise	–	14 1.5%	45 4.8%	244 25.9%	639 67.8%	943 100.0%	10 1.1%	933 98.9%
MEN	15 2.0%	119 16.0%	38 5.1%	113 15.2%	460 61.7%	744 100.0%	65 8.7%	680 91.3%
CVAS	22 10.8%	21 10.2%	17 8.2%	80 38.5%	67 32.2%	207 100.0%	49 23.4%	159 76.6%
GSM	20 8.1%	17 7.3%	11 4.5%	49 20.5%	143 59.7%	240 100.0%	123 51.0%	118 49.0%
MSS	13 20.3%	27 42.1%	3 4.6%	4 7.1%	16 26.0%	63 100.0%	14 21.7%	49 78.3%
Layer 4-7	–	1 5.0%	1 3.2%	9 51.4%	7 40.3%	18 100.0%	–	18 100.0%
Next Gen	–	–	2 19.1%	8 80.9%	–	10 100.0%	–	10 100.0%
Total	\$ 70 2.1%	\$ 213 6.3%	\$ 120 3.6%	\$ 765 22.7%	\$ 2,198 65.3%	\$ 3,365 100.0%	\$ 279 8.3%	\$ 3,087 91.7%

43. The following sections outline the approach advocated by the EMEA Debtors for allocating the proceeds attributable to each asset class, as well as the facts and evidence relevant to such allocation for each asset class. Because proceeds attributable to the value of Nortel IP

⁵⁷ Huffard Report ¶ 78.

⁵⁸ Huffard Report ¶ 78.

⁵⁹ Huffard Report ¶ 95.

make up the largest portion of the asset sale proceeds, our discussion commences with the approach to valuing and allocating IP.

IV. APPROACH TO ALLOCATION OF VALUE ATTRIBUTABLE TO IP

44. At Nortel, the five RPS entities collaborated by sharing the costs and efforts necessary to jointly develop the Group's IP and agreed to share the resulting commercial upsides and downsides of the IP. Up to the time when they sold the Lines of Business and the Residual Patent portfolio, the Nortel debtors shared the proceeds from exploitation of Nortel's IP based on their proportional contributions. The value of their respective contributions was determined by looking at relative R&D spending over the period when commercially valuable IP had been developed, *i.e.*, the "useful" or "economic" life of the IP. At the time of insolvency, the average useful life of all of the patents in Nortel's portfolio had been estimated to be five years – an unrealistically short figure chosen for tax-avoidance purposes – and this was the stated "look back" period for calculating relative R&D spending.

45. The EMEA Debtors advocate for using the same approach to allocate the asset sale proceeds attributable to IP as was used to allocate profits from exploitation of IP before the asset sales. Thus some of the key evidence presented to the Courts will relate to (i) the nature and organization of the R&D activities at Nortel, (ii) the agreements and understandings between the RPS entities regarding their respective rights and how they would share the revenues generated through exploitation of their jointly created IP, (iii) how the RPS entities characterized their rights and shared the revenues, (iv) how they actually conducted themselves, and (v) the dates of invention (*i.e.*, useful life) of the patents that were sold in the asset sales. Now that the IP has actually been sold, the Courts should base contribution on R&D spending over the period when

the commercially valuable patents were actually created, not the five-year estimate that had been applied when such data was not available.

A. Organization And Types Of R&D Activities At Nortel

46. The core of Nortel’s business was developing advanced telecommunications technology. Doing so depended upon creating and exploiting patents and other IP rights. It was the RPS entities that conducted the R&D activities that produced the patents that were the lifeblood of the Group’s business.⁶⁰ R&D was carried out in a highly collaborative manner and on a coordinated, integrated, groupwide basis.⁶¹ The resulting pool of IP comprised the overlapping and indivisible contributions of the five RPS entities that participated in R&D.

47. NNL’s former CFO Paviter Binning explained the interdependence of Nortel’s various entities on each other for R&D (and other functions) as follows:

Nortel’s R&D activities were integrated across statutory entities and the R&D organization relied on capabilities in different countries. R&D capabilities in any one specific country were not

⁶⁰ See NNSA Draft Functional Analysis for the Years Ended December 31, 2000–2004, at 5 (Ex. TR48763) (“The Nortel entities performing R&D activities (‘R&D Entities’) play the major role in this business and, [sic] work together to succeed in a very risky and competitive environment.”).

⁶¹ See Reply Affidavit of Brian McFadden ¶ 8, Apr. 25, 2014 [hereinafter “McFadden Reply Aff.”] (“Nortel was organized along global product lines and, similarly, global R&D projects. R&D was therefore organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis.”); Functional Analysis at 19 (Ex. TR21407) (“The R&D groups operate on the basis of technology, domain and program. Though there are several excellence centers across the globe, program plan execution is coordinated among a virtual team that is made up of various groups, in various locations, under various VPs. There is no one central geographic region that supports all activities.”); NNL-NNI Joint APA Request, app. B, at 17 (Ex. TR22078) (“Nortel R&D activities are on a global scale cross Canada, U.S., Europe, and Asia regions. On a highly coordinated and interdependent basis, R&D projects are structured and executed across the regions with products delivered to various lines of businesses. Not one single R&D location or region is solely responsible for all project components that make up a product.”).

broad enough to support or develop the product offerings of any individual line of business⁶²

48. Multiple laboratories in different countries would frequently work together on a given project, even handing off projects to each other to take advantage of their respective time zones.⁶³ In other cases, work in one laboratory would build off advancements previously achieved by others:

Much of Nortel's R&D is interrelated, and one specific project may be developed based upon older R&D projects or platforms. For example, assume that NNUK undertakes certain R&D that is not patented (e.g. possibly because it is not yet in a patentable form, or it would not meet the legal requirements to be patented). A year later, a portion of the information and intellectual property from NNUK's R&D is utilized by R&D personnel at NNL. NNL patents the results of its efforts. In this example, it is difficult to state that the patentable invention was purely the result of NNL's efforts – clearly, NNUK had some involvement in the process⁶⁴

49. In its submissions to various tax authorities in 2004 seeking approval of a new transfer pricing regime, Nortel described its R&D organization as follows:

⁶² Reply Affidavit of Paviter Binning ¶ 7, Apr. 24, 2014.

⁶³ Functional Analysis at 18 (Ex. TR21407) (“Researchers and engineers in Nortel’s facilities and partner locations around the globe collaborate to develop new, best in class products for which the Company is known.”); W. Henderson Tr. 210:14–17, Oct. 4, 2013 (confirming his understanding that “there would be multiple R&D centers in different locations, some in different countries that could perform R&D on the same product”); Email from Angela de Wilton, Law Dep’t, NNL, to Timothy Collins, Law Dep’t, NNL, et al. (Feb. 28, 2006, 8:30 a.m.), at NNC-NNL06607282 (Ex. TR21451) (cautioning against recognizing only the Canadian inventors on a patent, as “quite a few inventions have inventors from more than one location” and Nortel “encourage[s] collaboration across the company”); G. McColgan Tr. 52:8–54:2, Nov. 8, 2013 (noting “there were labs that worked together on an on-going basis on joint projects” and describing her experience as a U.K.-based engineer collaborating with laboratories outside of the United Kingdom).

⁶⁴ APA Responses to Questions Posed by Inland Revenue, IRS, and CCRA, at 8, 34 (Sept. 2003) (Ex. TR11169) (internal emphasis omitted); Functional Analysis at 30 (Ex. 21407) (same); NNL-NNI Joint APA Request, app. B, at 22 (Ex. TR22078) (same); *see also* Affidavit of Andrew Jeffries ¶ 25, Mar. 25, 2014 [hereinafter “Jeffries Aff.”].

The R&D groups operate on the basis of technology, domain and program. Though there are several excellence centers across the globe, program plan execution is coordinated among a virtual team that is made up of various groups, in various locations, under various VPs. There is no one central geographic region that supports all activities.⁶⁵

50. R&D at Nortel was integrated not just across geographies, but across platforms and technologies:

Much of Nortel's R&D is interrelated, and one specific project may be developed based on older R&D projects or platforms. For example, assume that it takes two years to develop Product A. A year later, a portion of the information and intellectual property from Product A is utilized by R&D personnel to develop Product B. Product B takes several additional years to develop into a commercially saleable product.⁶⁶

51. Engineers from one country were seconded to another country to apply their specific expertise to a particular issue or set of issues.⁶⁷ In addition to secondments, entire teams of researchers would also often engage in ad hoc "knowledge transfers" when one team's expertise was needed in other areas.⁶⁸ EMEA engineers both gave and received these knowledge transfers.⁶⁹

52. A good example of coordinated advanced research at Nortel comes from the Wireless Technology Laboratories ("WTL"). Nortel established the WTL in 1995, which included staff in

⁶⁵ Functional Analysis at 19 (Ex. TR21407).

⁶⁶ Functional Analysis at 24–25 (Ex. TR21407).

⁶⁷ *See, e.g.*, Affidavit of Geoffrey Stuart Hall ¶ 15, Apr. 10, 2014 [hereinafter "Hall Aff."] (discussing secondment to Ottawa while remaining an employee of NNUK).

⁶⁸ Affidavit of Simon Daniel Brueckheimer ¶ 42, Apr. 9, 2014 [hereinafter "Brueckheimer Aff."].

⁶⁹ Brueckheimer Aff. ¶¶ 42–43; *see also* Hall Aff. ¶ 15.

Canada, the United Kingdom, and the United States.⁷⁰ The WTL “operated as a single group combining staff and expertise of the wireless teams at Ottawa, Harlow, and Richardson. . . . [P]rojects and project teams were seamlessly integrated, with project teams spanning multiple sites drawing upon appropriate expertise as necessary.”⁷¹ Team members would work on projects depending on their experience, regardless of their geographic location.⁷² For example, CDMA was a specific form of 2G wireless technology that was almost exclusively adopted in the United States.⁷³ Nonetheless, U.K. engineers working on smart antenna and other technologies made key contributions towards crucial CDMA patents, as well as later 3G (UMTS) and 4G (LTE) technologies.⁷⁴

53. Once an invention had been created, the actual engineers responsible for it would disclose the invention to the IP legal team, which then drafted the patent application to be filed on behalf of the inventor.⁷⁵ Such a patent would be the legal property of the company that employed the inventor.⁷⁶ In accordance with the agreements between the Nortel entities, however, all such patents would eventually be assigned to NNL, which administered all of the Nortel Group’s IP.⁷⁷

⁷⁰ Jeffries Aff. ¶ 17.

⁷¹ Jeffries Aff. ¶ 19; *see also* B. McFadden Tr. 226:18–229:4, Oct. 21, 2013.

⁷² *See, e.g.*, Jeffries Aff. ¶¶ 17, 19; McFadden Reply Aff. ¶¶ 7–8.

⁷³ *See* CDMA Presentation to MatlinPatterson, at 6, 17–19 (July 7, 2009), NNI_00578024 (Ex. TR47251).

⁷⁴ Jeffries Aff. ¶¶ 24, 47; *see also id.* at ¶¶ 27, 45; Reply Affidavit of Angela Anderson ¶ 30, Apr. 25, 2014 [hereinafter “Anderson Reply Aff.”]; McFadden Reply Aff. ¶¶ 7–8.

⁷⁵ Anderson Reply Aff. ¶¶ 12, 15, 18.

⁷⁶ *See* Corporate Procedure No. 501.03 ¶ 4.1 (Jan. 23, 2004), at NNC-NNL06636716/2 (Ex. TR44686) (“All Employees are required, as a condition of employment or contract for services, to assign to Nortel Networks all rights to Inventions”); *see also* Brueckheimer Aff. ¶ 34 (“One of the terms of my employment with STC required me to assign all of my inventions to STC. It is my belief that these terms (and the patents assigned thereunder) were inherited by Nortel when Nortel acquired STC. All of the

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54. R&D activity at Nortel took many different forms. The highest value R&D work was advanced research aimed at discovering new, innovative technologies.⁷⁸ Advanced research was aimed at producing “foundational patents” – *i.e.*, patents “that represent the inception of a new area of ideas, or has influenced greatly a field of ideas.”⁷⁹ Foundational patents were produced in the laboratories of all five of the RPS entities.⁸⁰

55. Other types of R&D at Nortel included improving the technology in existing products in order to extend their commercial life, adapting products developed for one market to satisfy standards in another country,⁸¹ and adapting or customizing existing technologies to serve the needs of particular Nortel customers, including many instances in which engineers at one RPS entity worked to assist customers of other Nortel entities.⁸²

(Footnote continued from previous page)

patents that I invented while an NNUK employee were assigned to Nortel”); A. DeWilton Tr. 31:16–32:4, Nov. 20, 2013 (testifying to same); *cf. generally* U.S.P.T.O. Note of Recordation of Assignment Document (Nov. 26, 1999), NNI_ICEBERG_00076519 (Ex. TR44686).

⁷⁷ Master R&D Agreement art. 4(a), NNC-NNL06001514/6 (Ex. TR21003) (vesting legal title in NNL to present and future technology); *see also* Affidavit of Angela de Wilton ¶ 8, Apr. 11, 2014 (noting that IP was assigned “directly or indirectly” to NNL).

⁷⁸ *See* Anderson Reply Aff. ¶¶ 30, 32 (discussing development in the Harlow facility of foundational patents and high-quality inventions).

⁷⁹ Brueckheimer Aff. ¶ 29.

⁸⁰ *See* Anderson Reply Aff. ¶ 32 (discussing high-quality R&D coming out of EMEA sites); McFadden Aff. ¶ 16 (discussing centrality of Canadian R&D).

⁸¹ *See* Hall Aff. ¶¶ 8, 12, 15.

⁸² Jeffries Aff. ¶¶ 21, 52–54.

56. Sometimes Nortel engineers also developed “defensive” IP in a field occupied by a competitor.⁸³ Holding patents related to a competitor’s technology could generate value by (i) creating an opportunity for Nortel to demand licensing royalties, (ii) allowing Nortel to initiate an action for infringement, (iii) deterring infringement actions by these same competitors against Nortel products that might arguably infringe the competitors’ IP, or (iv) serving as the basis for cross-license agreements with Nortel competitors.⁸⁴

57. While the commingled and cooperative nature of R&D conducted by Nortel means that inventorship per se is not a reliable metric for measuring contribution to the development of the patented technologies, inventorship is a useful sense check against the results of the proposed allocation methodologies.

58. As part of preparing the residual patents for sale, Nortel retained Global IP Law Group, LLC to assess the portfolio and group the patents into one-star, two-star, and zero-star ratings.⁸⁵ The more stars assigned to a patent, the higher the interest Global IP assessed the participants in the relevant market to have in that patent, indicating it had potentially higher value than other

⁸³ Cf. Affidavit of Peter Newcombe ¶ 20, Apr. 11, 2014 [hereinafter “Newcombe Aff.”] (“The NNUK laboratories performed significant long term research directed at what might years later become embodied in products in our industry. . . . ‘Development’ work was also done on a shorter timeframe with a shorter commercial ‘product aligned’ goal in mind.”).

⁸⁴ Expert Report of Catherine Tucker ¶¶ 77–81 (Feb. 28, 2014) [hereinafter “Tucker Report”]; see also Jeffries Aff. ¶ 22 (“Patent filings, and especially early patent filings, were very important to Nortel. They enabled Nortel to be a ‘player’ within the industry because the patents could be traded against patents belonging to its competitors, sold to other companies, or licensed to other companies (particularly if those patents were embedded into standards).”).

⁸⁵ See Malackowski Report 33; Order Under 11 U.S.C. §§ 327 and 328 Authorizing Employment and Retention of Global IP Law Group, LLC *Nunc Pro Tunc* as Intellectual Property Consultant to the Debtors and Debtors in Possession (Nov. 19, 2009) [D.I. 1928] (Ex. TR50138).

patents.⁸⁶ The high-interest patents were mostly patents that had not yet been incorporated into an existing Nortel business or product, so they tended to have been obtained either for defensive purposes or as the result of advanced research.⁸⁷ EMEA R&D personnel were listed as the inventors on 18.7% of the high-interest residual patents (and 17.7% of all patents contained in the Residual Patent portfolio),⁸⁸ as well as 21.8% of the patents sold in the Business Sales.⁸⁹ The EMEA labs were also extremely efficient in this regard, consistently producing “substantially more patents per head than elsewhere in the Nortel Group.”⁹⁰

B. How The Parties Agreed To Share Costs And Profits From Their R&D Activity

59. Over the years, the five RPS entities adopted several approaches to allocating the costs of R&D as well as the profits and losses that would result from commercial exploitation of the resulting IP. They conformed their agreements to the “arm’s length standard” embodied in the transfer pricing regulations of the United States, Canada, the United Kingdom, and other developed economies in which Nortel did business. In applying the arm’s length standard, Nortel adopted an approach that necessarily addresses the very question at issue here: how to allocate the proceeds of selling IP.

⁸⁶ Malackowski Report 33, 41.

⁸⁷ See McColgan Tr. 61:23–62:23, Nov. 8, 2013 (explaining that a larger portion of Nortel’s patenting spending was forward-looking and defensive, with an intention to protect Nortel from competitors).

⁸⁸ Malackowski Rebuttal 40.

⁸⁹ Nortel Networks Allocation of Sales Proceeds to the Nortel Debtor Groups ¶ 6.17 tbl. 4 (Feb. 28, 2014) [hereinafter “Britven Rebuttal”].

⁹⁰ Hall Aff. ¶ 46; Brueckheimer Aff. ¶ 31; see also Anderson Reply Aff. ¶ 32.

60. Transfer pricing refers broadly to the set of internationally accepted principles that have been developed by the governments of the major economic powers to determine how the revenues of a multinational enterprise should be allocated among the individual entities within that enterprise.⁹¹ The main objective of these principles is to ensure that the profits of a global enterprise accrue in the appropriate geographic entities for taxation purposes, so that tax revenues end up in the right coffers and companies do not suffer double taxation.⁹²

61. In its simplest form, transfer pricing is concerned with determining the price one entity in a corporate group should pay for goods or services it receives from another entity in the group.⁹³ More broadly, transfer pricing principles are designed to ensure that each entity in a corporate group receives an appropriate return whenever anything of value moves from it to another

⁹¹ See, e.g., Expert Report of Lorraine Eden ¶ 28 (Jan. 24, 2014) (Ex. 11428) [hereinafter “Eden Report”] (“In the United States, the arm’s length standard was initially adopted into law in 1928, when Section 45 of the IRC was added to authorize the IRS Commissioner to **allocate income** and deductions among related corporate entities so as to prevent tax avoidance and determine the true taxable liability of the related parties.” (emphasis added)); Lorraine Eden, *Taxes, Transfer Pricing, and the Multinational Enterprise*, in *The Oxford Handbook of International Business* 596 (Alan M. Rugman ed., 2009), NNI_01570321 at NNI_01570326 (Ex. TR48812) (“From the government’s perspective, the global reach of the multinational raises three types of taxation problems: *jurisdiction, allocation, and valuation*. . . . From the government’s perspective, how should the costs of, and income from, these resources be allocated among jurisdictions?” (italics in original; emphasis added)).

⁹² Allocation Expert Report of Richard V.L. Cooper 10 (Jan. 24, 2014) [hereinafter “Cooper Allocation Report”] (“[R]elevant tax authorities will not want to see taxable revenue shifted out of their jurisdictions as a result of non-arm’s length intercompany pricing.”); see also Report of Dr. Timothy Reichert, Evaluation and Economic Analysis, The Nortel Network Group’s Intercompany Transfer Pricing Arrangements 16 (Jan. 24, 2014) [hereinafter “Reichert Report”] (“The arm’s length standard is also a tool to avoid ‘double taxation’ of a firm.”).

⁹³ Cooper Allocation Report 10 (“‘Transfer pricing’ is a tool used to evaluate and, if necessary, assign prices reflecting economic realities in transactions and activities among divisions or constituents of commonly controlled enterprises.”).

entity.⁹⁴ The need for a specialized body of law in this area arises because companies within a corporate group (referred to in transfer pricing guidance as “controlled entities”) are not autonomous and are not capable of bargaining over transaction terms the way independent commercial parties would.⁹⁵ To meet the arm’s length standard, a multinational enterprise must be able to show that the revenue of the group is being allocated among the entities in the group in a manner approximating terms that would be agreed between unrelated parties bargaining at arm’s length in a competitive market.⁹⁶

62. Governments accept a number of established transfer pricing methodologies, depending on the nature of the business.⁹⁷

1. *The Cost Sharing Agreements*

63. From prior to 1992 through 2000, the Nortel group operated under a series of Cost Sharing Agreements that had been approved by several revenue authorities (*i.e.*, CRA in Canada and IRS in the United States) through a series of Advanced Pricing Agreements (“APAs”). Under the Cost Sharing Agreements, the parties “shared in the costs of R&D performed globally

⁹⁴ Cooper Allocation Report 10 (“Transfer pricing evaluates whether pricing meets the arm’s length standard, and, if not, adjusts the pricing associated with related party transactions to approximate the corresponding pricing that would have applied in arm’s length transactions.”).

⁹⁵ Lorraine Eden, *Taxes, Transfer Pricing, and the Multinational Enterprise*, in *The Oxford Handbook of International Business* 601 (Alan M. Rugman ed., 2009), NNI_01570321 at NNI_01570331 (Ex. TR48812) (“The arm’s length standard asks the question: What price would the parties have negotiated if the entities had been unrelated? Since the firms *are* related, the answer to this question has to be hypothetical.”).

⁹⁶ Cooper Allocation Report 10 (“The result of properly functioning transfer pricing arrangements is that income is recorded in the appropriate legal entity based on what the legal entity would have earned had it participated in the activities in question purely on an arm’s length basis.”).

⁹⁷ Eden Report ¶ 20B.

in proportion to the economic benefit received by the participant in its geographic territory.”⁹⁸ The way this was accomplished was that (i) the participating Nortel companies would expend funds on R&D during a particular year, (ii) at year end, the proportional economic benefit that accrued to each participant was measured by comparing the participants’ results based on a modified form of operating income,⁹⁹ (iii) with “true up” payments contemplated among the participants to ensure that the proportion of total R&D costs borne by each participant corresponded to its proportional share of the Group’s operating income.¹⁰⁰

64. NNL administered the patent portfolio on behalf of the Group, and for this purpose, legal title to all Nortel IP was “vested” in NNL.¹⁰¹ Each participant was granted an unrestricted, exclusive license to all of Nortel’s IP in its operating territory.¹⁰² Although balancing payments were made in order to adjust the amount of R&D spending borne by each participant to reflect its relative share of group revenues, each participant was allowed to keep 100% of the revenues it collected from the exploitation of Nortel’s IP in its operating territory.¹⁰³ Additionally, the CSAs memorialized how the participants “wish[ed] to share the costs and risks of research and development services or activities in return for interests in any NT Technology that may be

⁹⁸ Cooper Allocation Report 13.

⁹⁹ *See, e.g.*, Cost Sharing Agreement between Northern Telecom Limited and Nortel Limited, art. 1(n) (Jan. 1, 1995) (Ex. TR33067) [hereinafter “NNUK CSA”]; *see also* Declaration of Walter T. Henderson, Jr. ¶ 20, Apr. 11, 2014 [hereinafter “Henderson Decl.”] (“The Nortel affiliates who were parties to the R&D CSA (‘CSA Participants’) shared their global R&D costs pursuant to a three-part formula that allocated costs to each CSA Participant based on its (i) royalty income, (ii) net customer sales, and (iii) modified operating income.”).

¹⁰⁰ *See, e.g.*, NNUK CSA art. 3 (Ex. TR33067).

¹⁰¹ *See, e.g.*, NNUK CSA art. 4 (Ex. TR33067); *see also* Henderson Decl. ¶¶ 23, 55.

¹⁰² *See, e.g.*, NNUK CSA art. 5 (Ex. TR33067); *see also* Anderson Reply Aff. ¶ 38.

¹⁰³ *See, e.g.*, NNUK CSA art. 3 (Ex. TR33067).

produced by such services or activities.”¹⁰⁴ The net result of these arrangements, according to Nortel’s submissions to tax authorities in 2002, was that “[f]rom an economic standpoint, each R&D cost sharing participant could be considered to ‘own’ the NT technology as it related to its specific region.”¹⁰⁵

2. *The Shift to the Residual Profit Split Methodology*

65. In 2001, as a result of changes in Nortel’s business, the expiration of the previous APA, and at the suggestion of the tax authorities, Nortel decided to change its approach to allocating R&D spending and the profits from exploiting the Group’s IP.¹⁰⁶ Effective from 2001 onward, Nortel adopted the “Residual Profit Split Methodology” as a new means to comply with the arm’s length standard. Pursuant to this methodology, the RPS entities shared profits in accordance with the beneficial interests that accrued as a result of their relative contributions to the jointly created IP.¹⁰⁷

¹⁰⁴ See, e.g., NNUK CSA, third recital (Ex. TR33067).

¹⁰⁵ See Horst Frisch Inc., Economic Analysis of Nortel Networks’ Intercompany Transactions, at 10 (Mar. 14, 2002) (Ex. TR22123) [hereinafter “Horst Frisch Report”].

¹⁰⁶ See Horst Frisch Report tbl. 1 (Ex. TR22123) (noting Nortel’s recent major business acquisitions); see also Overview of Objectives of December 12, 2001 Presentation (Dec. 2, 2001) (Ex. TR11058) (“For several reasons, the R&D Cost Sharing Agreement (‘R&D CSA’) Nortel has utilized since 1992 needs to be replaced with a new transfer pricing methodology. The reasons include: (a) the expiration of the APA covering the R&D CSA (which was effective until 12/31/1999); (b) the fact that neither of the major tax authorities (the CCRA, the IRS or the Inland Revenue) wants to renew the R&D CSA APA for years subsequent to 1999; and (c) the fact that the R&D CSA does not effectively allocate R&D expenses among participants during 2001 due to the large operating losses. Furthermore, changes in Nortel’s business operations (e.g., gradual outsourcing of contract manufacturing) have necessitated a reexamination of our methods for determining intercompany transfer pricing.”); Henderson Decl. ¶ 31 (discussing Ex. TR11058).

¹⁰⁷ See Master R&D Agreement sched. A, NNC-NNL06001514/18 (Ex. TR21003) (“The current transfer pricing methodology is the residual profit split method (‘RPSM’) which was adopted by the Participants at the request of the tax authorities as the most appropriate method for determining the arm’s length compensation to each of the Participants for the R&D Activity to be provided pursuant to the Master R&D

(Footnote continued on next page)

66. Under the Residual Profit Split Methodology, instead of allocating the parties' R&D costs to match their proportion of Group operating income, the parties allocated Group operating income or losses each year based on the relative contributions that each participant had made to the creation of commercially viable IP.¹⁰⁸ Meanwhile the five RPS entities (the only participants that bore "the full entrepreneurial risks and benefits for the Nortel Networks business" under the Residual Profit Split Methodology¹⁰⁹) continued to transfer bare legal title to new inventions to NNL.¹¹⁰

67. Although the parties continued to be the beneficial owners of Nortel's IP under the Residual Profit Split Methodology, the nature of that interest changed. Under the Cost Sharing Agreements, each participant had been entitled to keep 100% of the profits from exploiting Nortel's IP in its region.¹¹¹ Under the Residual Profit Split Methodology, each of the parties held a beneficial and economic interest in all Nortel IP, which was reflected in the fact that they shared all profits from all forms of the exploitation of all of Nortel's IP in all global markets.¹¹²

(Footnote continued from previous page)

Agreement. . . . Accordingly, the compensation provided to Participants under RPSM reflects the fact that the Participants bear the full entrepreneurial risk of the Nortel business such as the risks attendant with the substantial and continuous development and ownership of the NN Technology.”).

¹⁰⁸ See Henderson Decl. ¶¶ 37–38.

¹⁰⁹ Master R&D Agreement at 2, NNC-NNL06001514/2 (Ex. TR21003).

¹¹⁰ See Henderson Decl. ¶ 55.

¹¹¹ See Cooper Allocation Report 14.

¹¹² See Affidavit of Aylwin Kersey Stephens ¶ 20, Apr. 11, 2014 [hereinafter “Stephens Aff.”] (“I had understood that the RPSM participants owned Nortel’s intellectual property and were entitled to receive the economic benefits from exploiting it in proportion to their relative contributions to the creation of that intellectual property.”); Affidavit of Philippe Albert-Lebrun ¶ 20, served Apr. 11, 2014 [hereinafter “Albert-Lebrun Aff.”] (“As it was impractical to determine for each element of Nortel’s IP which entity owned what ‘percentage’ of that item of IP, I understood the RPSM was instead designed to be based on the joint ownership of substantially all of Nortel’s IP. . . . The fact that NNSA was an economic owner of

(Footnote continued on next page)

The value of each RPS entity's relative contribution was measured by its historical R&D spending over the estimated useful life of the IP.¹¹³

68. Although Nortel began applying the Residual Profit Split Methodology in 2001, it was not, initially, memorialized in any written agreement between the RPS entities. Nor were the territorial licenses, initially, continued. Indeed, Nortel personnel anticipated that the exclusive territorial licenses would be replaced by nonexclusive licenses covering the entire world,¹¹⁴ corresponding to the RPS entities' beneficial interest in the global proceeds from exploiting Nortel's IP.

69. In March 2002, in order to obtain approval of its new methodology, Nortel submitted applications to the U.S., Canadian, and U.K. taxation authorities.¹¹⁵ Prior to these applications, Nortel had engaged Horst Frisch Inc., a leading firm in the field of transfer pricing, to evaluate possible transfer pricing methods and to confirm the methodology that was most appropriate for Nortel. Horst Frisch prepared a report, which Nortel attached to its APA applications, concluding that the Residual Profit Split Methodology was the "best method" for Nortel.¹¹⁶

(Footnote continued from previous page)

Nortel's intellectual property was a critical factor for justifying to me that NNSA could legitimately participate in the RPSM in its own interests.").

¹¹³ See Cooper Allocation Report 21, 31.

¹¹⁴ Henderson Decl. ¶ 55.

¹¹⁵ See Letter from Kriss Bush, Vice President, Global Tax, to I. Wood, U.K. Inland Revenue (Mar. 27, 2002) (Ex. TR22122); Letter from Kriss Bush, Vice President, Global Tax, to S. Foley, I.R.S. (Mar. 14, 2002) (Ex. TR22122); Letter from Kriss Bush, Vice President, Global Tax, to Jim Gauvreau, CCRA (Mar. 14, 2002) (TR22122).

¹¹⁶ See Letter from Kriss Bush, Vice President, Global Tax, to I. Wood, U.K. Inland Revenue (Mar. 27, 2002) (Ex. TR22122); Letter from Kriss Bush, Vice President, Global Tax, to S. Foley, I.R.S. (Mar. 14, 2002)

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Significantly, that report described the parties’ economic and beneficial interests and how each party would “own” its share of IP:

In an intercompany sale from an old [cost sharing participant] to another old [cost sharing participant], under our characterization of the R&D “owner” in the absence of the [Cost Sharing Agreement], the intercompany selling entity will own some portion of the R&D-related intangibles by virtue of its current (and future) R&D expenses, and the distributor will own some portion of the R&D-related intangibles by virtue of 1) its current (and future) R&D expenses, and 2) its historic R&D investment (under the [Cost Sharing Agreement]).¹¹⁷

70. Thus, the Residual Profit Split Methodology confirmed that the parties would “own” the intangibles by virtue of their contributions to R&D.¹¹⁸

3. *The Master R&D Agreement*

71. In 2004, frustrated with the lack of progress on the 2002 APA application, Nortel sought advice from the law firm of Sutherland Asbill & Brennan LLP to assist it in breaking the “logjam.”¹¹⁹ In order to assist with presentations to the IRS and other tax authorities, Sutherland Asbill recommended that Nortel memorialize the Residual Profit Split Methodology in a written

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(Ex. TR22122); Letter from Kriss Bush, Vice President, Global Tax, to Jim Gauvreau, CCRA (Mar. 14, 2002) (Ex. TR22122).

¹¹⁷ Horst Frisch Report 13–14 (Ex. TR22123).

¹¹⁸ The Nortel AREs, including Nortel Networks France S.A.S. and Nortel GmbH, conducted their own R&D and held IP in their own names. The AREs, not the RPS entities, owned this subset of IP. Huffard Report ¶¶ 29–30; Malackowski Report 45–47.

¹¹⁹ G. Sparagna Tr. 130:24–131:2, Dec. 10, 2013.

agreement between the parties.¹²⁰ Nortel accepted this advice and, in late 2004, finalized the Master R&D Agreement. Dated as of December 22, 2004, the Master R&D Agreement was stated to be effective retroactively to January 1, 2001.¹²¹

72. At the outset, the Master R&D Agreement confirmed the parties' intention to share in the fruits of their joint endeavor in accordance with their relative contributions: "each [party] believes that it is appropriate that each [party] should benefit from its contribution to R&D activity commensurate with the value of its contributions to that R&D activity."¹²²

73. The Master R&D Agreement contained three salient terms:

i. First, Article 3(a) confirmed the right of each RPS entity to a proportional share of the profits to be earned from exploiting Nortel's IP:

For and as a consequence of the performance of R&D Activity, each [party] shall be entitled to receive a payment in an amount equal to the allocation determined under the [Residual Profit Split Methodology] (the "R&D Allocation") as the measure of the benefit to which it is entitled commensurate with its performance of, and contribution to, R&D Activity.¹²³

¹²⁰ G. Sparagna Tr. 134:2–135:6, Dec. 10, 2013; *see also* Letter from Giovanna Sparagna to John Doolittle (July 16, 2003), at SUTHERLAND_00001456-59 (Ex. TR11340) (suggesting that Nortel "build a global defense template" and "develop core documentation" in support of its transfer pricing methodology).

¹²¹ Master R&D Agreement at 1, NNC-NNL06001514/1 (Ex. TR21003).

¹²² Master R&D Agreement at 2, NNC-NNL06001514/2 (Ex. TR21003).

¹²³ Master R&D Agreement art. 3(a), NNC-NNL06001514/5 (Ex. TR21003).

Schedule A to the Master R&D Agreement provided the actual formula for calculating the residual profit split, including the “look back” period for calculating relative R&D spending, as adjusted from time to time.¹²⁴

ii. Second, Article 4(a) confirmed that the parties would continue to vest in NNL “legal title” to the IP they created.¹²⁵

iii. Third, Article 5 reinstated the exclusive geographic licenses to exploit Nortel’s IP that had applied under the Cost Sharing Agreements.¹²⁶

C. How The Master R&D Agreement Confirms The Parties’ Joint Ownership Of And Interest In Nortel IP

74. The Master R&D Agreement’s first two recitals state that NNL holds legal title, while the other parties hold “equitable and beneficial ownership of certain exclusive rights under NT Technology for a Specified Territory.”¹²⁷ The third and fourth recitals clarify the nature of the parties’ “equitable and beneficial ownership,” stating expressly that each party “bears the full entrepreneurial risks and benefits for the Nortel Networks business” and that each party “should benefit from its contribution to R&D activity commensurate with the value of its contribution to that R&D.”¹²⁸

¹²⁴ Master R&D Agreement sched. A, NNC-NNL06001514/18 (Ex. TR21003).

¹²⁵ Master R&D Agreement art. 4(a), NNC-NNL06001514/6 (Ex. TR21003).

¹²⁶ Master R&D Agreement art. 5, NNC-NNL06001514/6 (Ex. TR21003).

¹²⁷ Master R&D Agreement at 2, NNC-NNL06001514/2 (Ex. TR21003).

¹²⁸ Master R&D Agreement at 2, NNC-NNL06001514/2 (Ex. TR21003).

75. Article 4(a) of the Master R&D Agreement similarly recognizes the nature of the parties' interests in NN Technology. It specifically vests only "legal title" to all NN Technology – not equitable and beneficial ownership, to use the language of the second recital – in NNL.¹²⁹

76. Article 5(a) is also entirely consistent with the joint ownership that Nortel consistently represented to tax authorities and in the Master R&D Agreement. NNL is entitled to grant licenses because it holds legal title to the patents. Exclusive licensing arrangements were necessary because absent further agreement, the parties could not legally enforce their rights in their exclusive territories. As discussed below, when Nortel enforced these rights and obtained payment for infringement of its IP in the United States, NNL and NNI shared the proceeds among the parties as joint owners.

77. The Master R&D Agreement was amended five times. The first amendment "correct[ed] certain minor errors" and did not change any terms.¹³⁰ The second amendment principally amended provisions relating to the exit of parties from the R&D arrangement.¹³¹ The next amendment, the "Alcatel Addendum," was "entered into as of the day before the Closing of the Share and Asset Sale Agreement between NNL and Alcatel," which was December 30, 2006.¹³² The Alcatel Addendum redefines the Nortel technology subject to the Master R&D Agreement

¹²⁹ Master R&D Agreement art. 4(a), NNC-NNL06001514/6 (Ex. TR21003).

¹³⁰ Addendum to Master R&D Agreement, NNC-NNL06001514/21 (Ex. TR21003).

¹³¹ See [Second] Addendum to Master R&D Agreement, NNC-NNL06001514/27 (Ex. TR21003).

¹³² Agreement with Respect to Certain NN Technology (Dec. 30, 2006), at NNC-NNL06001516/1 (Ex. TR44056).

to exclude the assets transferred to Alcatel.¹³³ However, as discussed below, Nortel followed the principles of the Residual Profit Split Methodology to divide the proceeds relating to the intellectual property sold to Alcatel, *i.e.*, based on the beneficial ownership rights of the parties.

78. The next amendment (the “Third Addendum”) was executed on the eve of insolvency proceedings on various dates from December 19, 2008 through January 13, 2009.¹³⁴ The Third Addendum contained three significant provisions: (i) it expressly granted the RPS entities nonexclusive licenses with respect to the entire world except Canada and the territories for which the EMEA and U.S. RPS entities held exclusive licenses, (ii) it stated that the “gain/loss on the sale of business” would be excluded from “operating earnings/loss” in the RPS calculation, and (iii) it changed the method for calculating the RPS entities’ R&D contributions, including setting a flat five-year period for useful life of all IP.¹³⁵

79. The EMEA parties were initially reluctant to sign the Third Addendum and questioned whether it was in their economic interests to do so.¹³⁶ Ultimately, the EMEA parties agreed to sign the Third Addendum only after NNL presented the Third Addendum as a “package” deal

¹³³ Agreement with Respect to Certain NN Technology (Dec. 30, 2006), at NNC-NNL06001516/2 (Ex. TR44056).

¹³⁴ Third Addendum to Master R&D Agreement, NNC-NNL06001514/39–50 (Ex. TR21003).

¹³⁵ Third Addendum to Master R&D Agreement § V, sched. A, NNC-NNL06001514/41–42, 49 (Ex. TR21003).

¹³⁶ See Email from Derrick Tay, Ogilvy Renault LLP, to Sandy Shandro, South Square (Feb. 1, 2009, 10:17 p.m.), at NNC-NNL06128186/4 (Ex. TR44437) (discussing the EMEA directors’ reluctance to sign the Third Addendum).

with the “Fourth Addendum.”¹³⁷ The Fourth Addendum provided a “Standstill Provision” which prevented the triggering of certain termination provisions in the Master R&D Agreement upon the commencement of insolvency proceedings.¹³⁸ If such termination provisions were triggered, the EMEA and U.S. RPS entities would have been forced to withdraw from the Master R&D Agreement.

80. On or around the time the parties executed the Third and Fourth Addendums, they also entered into a “Memorandum of Understanding.”¹³⁹ This Memorandum of Understanding confirmed that the parties held “ownership interests” in the Group’s intellectual property. Paragraph 6 provides in part:

The [parties] believe that, through the date hereof under the prior formula, and going forward under the new formula as amended in the Third Addendum to the 2004 Agreement executed on the date hereof with effect from January 1, 2006 (‘Third Addendum’), **their respective ownership interests in the NN Technology** and their respective R&D Activity have been and will be adequately and fairly compensated, as envisioned in the APA discussions referenced in Paragraph 5 above.¹⁴⁰

81. The fact that NNL held legal title to the jointly created IP did not give it any greater right to the profits from exploiting Nortel’s IP than any of the other parties, nor did NNL ever receive

¹³⁷ See Email from Derrick Tay, Ogilvy Renault LLP, to Justin Vaughan, Herbert Smith, et al. (Jan. 5, 2009, 10:02 a.m.), at NNC-NNL06128186/4 (Ex. TR44437) (confirming that the Third and Fourth Addenda were a “package deal”).

¹³⁸ Fourth Addendum to Master R&D Agreement § II, NNC-NNL06001514/59 (Ex. TR21003).

¹³⁹ Memorandum of Understanding (Dec. 22, 2008), NNC-NNL06128094 (Ex. TR44436).

¹⁴⁰ Memorandum of Understanding ¶ 6 (Dec. 22, 2008), at NNC-NNL06128094/2 (Ex. TR44436) (emphasis added).

any such greater benefits. As far as beneficial and economic rights were concerned, NNL was in exactly the same position as each of the other parties.

D. The Contribution Approach To Allocating Proceeds Attributable To IP

82. The contribution approach is consistent with the arrangements between the parties and the manner in which they routinely divided the fruits of the exploitation of Nortel's IP. It is also the approach mandated by the underlying legal rights of the parties, and the one that gives them the value of the economic rights they relinquished in the asset sales.

83. At the time of the Business Sales and the Residual Patent Sale, the EMEA Debtors held beneficial ownership interests in all of Nortel's IP. Engineers in the EMEA Debtors' labs were the original inventors of many of the Nortel patents, and they collaborated with other RPS entities on many more. Given the intertwined and indivisible nature of R&D at Nortel, it was not possible to separate out each RPS entity's contributions, and so the parties recognized that they each held a partial beneficial interest in all of Nortel's IP. Although legal title to these patents was assigned to NNL, as the Nortel entity responsible for administering all of the Group's IP, the EMEA Debtors never surrendered their beneficial ownership rights in the IP. As a result, they are entitled to an allocation of the IP sale proceeds based on the proportional value of their contributions to the creation of the IP that was sold in the asset sales. The best measure of their proportional contribution is the one chosen by the parties themselves for allocating the profits of exploiting Nortel's IP, *i.e.*, relative R&D spending over the useful life of the IP conveyed in the Business Sales and the Residual Patent Sale.

84. The same result is required by the arm's length standard, the objective test adopted by all the major commercial nations for determining how the revenues of a multinational enterprise

should be divided among the companies within the enterprise. The arm's length standard requires that profits be allocated in a manner such that each company receives a share of profits proportional to the value it has contributed to the enterprise. Where group companies have collaborated to create intangible assets such as IP, the use of relative R&D spending over the period when the IP was developed is an accepted and appropriate measure for allocating the proceeds from all forms of exploitation of the intangible assets.

E. Nortel's Statements And Conduct Confirmed That The RPS Entities Were The Beneficial Owners Of Nortel's IP Entitled To Share In The Proceeds Of All Forms Of Exploitation Of IP In Accordance With Their Relative Contributions.

1. Statements Prior to Adoption of the Master R&D Agreement

85. Nortel's representations to tax authorities in Canada, the United States, and the United Kingdom all emphasized that since R&D was the principal driver of Nortel's success or failure, the parties that created that R&D "**should share equitably in the residual profits and losses of Nortel.**"¹⁴¹

86. Similarly, a "Functional Analysis" that Nortel commissioned from Ernst & Young (Canada), for the tax authorities, emphasized that economic interests were commensurate with R&D spending:

The [parties] each perform R&D that contributes to Nortel's innovation and new products. **Each [party] continues to share entrepreneurial risks.** The allocation of the Company's profit or loss should be commensurate with its risks associated with the company's R&D.¹⁴²

¹⁴¹ Letter from David J. Canale to Thomas Ralph, IRS, at 2 (Nov. 30, 2004) (Ex. TR21407) (emphasis added).

¹⁴² Functional Analysis at 48 (Ex. TR21407).

87. In preparing for a June 19, 2002 meeting with tax authorities from Canada, the United States, and the United Kingdom to discuss adoption of the Residual Profit Split Methodology, Nortel prepared a briefing document that explicitly endorsed the position that the EMEA Debtors – and only the EMEA Debtors – now advance over ten years later:

[Q:] How does Nortel propose to account for any future sale of intellectual property developed prior to or during the term of the APA? Which entities are considered the legal owner of IP and which are considered the economic owners?

[A:] **Proceeds from the sale of IP will be allocated to residual profit split participants on the basis of their economic ownership of the IP – that is, on the basis of their share of total R&D capital stock in the year of sale.**¹⁴³

88. Similarly, in 2002 Nortel was considering the departure of NNSA from the Residual Profit Split Methodology, although it ultimately chose not to and NNSA remained a significant R&D contributor until Nortel's insolvency filings. James Gatley, NNL's transfer pricing leader, wrote to Scott Wilkie, a transfer pricing lawyer at Osler Hoskin & Harcourt LLP, Canadian tax counsel to NNL, seeking Mr. Wilkie's advice on the implications and structure of such a departure.¹⁴⁴ As part of his instructions to Mr. Wilkie, Mr. Gatley of NNL stated as a

¹⁴³ APA Kick Off Meeting: Potential Questions and Sample Answers, at 39, at NNI_00327148 (Ex. TR22020) (attached to Email from Gilles Fortier to James Gatley (May 20, 2003, 5:27 p.m.) (Ex. TR22019)); *see also* M. Poland Tr. 162:3–164:21, Oct. 3, 2013.

¹⁴⁴ *See generally* Memorandum from James Gatley, NNL, to Scott Wilkie, Osler Hoskin & Harcourt LLP (Nov. 14, 2002) (Ex. TR21382).

background fact that “the effect of the RPS model is that the future intangibles developed are beneficially owned” by the contributing parties.¹⁴⁵

2. *Statements After Adoption of the Master R&D Agreement*

89. In 2006, Nortel was determining whether the value of NNSA needed to be written down in Nortel’s financial statements in light of ongoing losses.¹⁴⁶ The company concluded, in an email to NNI’s secondee to EMEA, Ryan Smith, and other EMEA employees, that no such write-down was necessary because of the value of NNSA’s ownership of IP as a result of performing R&D:

NNSA participates in R&D and with the other Nortel R&D participants across the world owns a share in the IP that has been generated over years of R&D. Globally this IP is valued in the region of US\$6 – US\$8 billion, and the NNSA share in this is approximately 8 – 10% or US\$650M. The IP or goodwill asset is not capitalised in Nortel’s balance sheet, it is internally generated, but it does have economic value.

The calculation of this IP or goodwill asset is per the Residual Profit Share (or RPS) model. NNSA is party to the RPS agreement along with Nortel’s other R&D participants globally. The overall effect of the RPS mechanism is for RPS participants to share the ‘residual’ profits of Nortel globally, that is the profits remaining once all the distributor entities have taken their margin through the transfer pricing agreements. The IP or goodwill asset is calculated based upon R&D spend across earlier years less a factor for depreciation.¹⁴⁷

¹⁴⁵ Memorandum from James Gatley, NNL, to Scott Wilkie, Osler Hoskin & Harcourt LLP, at 1 (Nov. 14, 2002) (Ex. TR21382). The participants in the CSA at the time included five RPS entities as well as NNL’s Australian subsidiary.

¹⁴⁶ Albert-Lebrun Aff. ¶ 29.

¹⁴⁷ Email from Tony Mcardle, Finance Dep’t, EMEA, to Ryan Smith, Tax, NNI, *et al.* (Sept. 20, 2006, 10:53 a.m.) (Ex. TR11206); R. Smith Tr. 322:7–323:24, Oct. 22, 2013; *see also* Albert-Lebrun Aff. ¶ 30.

90. Starting in 2007, Nortel began to negotiate arrangements with the Canadian and U.S. revenue authorities. As part of that process, Nortel represented that “[a]ll intellectual property (“IP”) created from the investment in R&D by the [parties] is registered by NNL. Each [party] maintains an economic ownership in the IP.”¹⁴⁸

3. *Evidence in these Proceedings*

91. Senior Nortel executives responsible for drafting the Master R&D Agreement and implementing transfer pricing policy confirmed in their deposition testimony that the representations to tax authorities accurately reflected the parties’ underlying economic ownership of Nortel IP. For example, in Mr. Gatley’s experience, legal title to IP was meaningless.¹⁴⁹ Instead, transfer pricing had to reflect the fact that the RPS entities had created and therefore held economic interests in the IP:

You can have Nortel Canada register all the patents or they could have been registered in the U.S., I don’t know. **But let’s say for the sake of this example, all the patents were registered by Canada. To me, that means nothing. What I’m concerned with from a transfer pricing perspective is who contributed to the development of the intangibles associated with that patent?** And that might be R&D undertaken in the U.K. or R&D undertaken in Australia and Canada. So if those three entities contributed to developing the R&D and allowed Canada to register a patent, I’m not considered – I’m not concerned with the registration of the patent. **I’m concerned with making sure that everybody who helped develop that intellectual property is**

¹⁴⁸ NNL-NNI Joint APA Request at 11–12 (Ex. TR22078).

¹⁴⁹ J. Gatley Tr. 252:9–253:8, Nov. 7, 2013; *see also* M. Weisz Tr. 118:10–119:5, Nov. 25, 2013 (noting that under the MRDA, “legal IP ownership was irrelevant”).

compensated properly for their efforts through the transfer pricing model.¹⁵⁰

92. Mr. Gatley’s testimony is consistent with the arm’s length principle that governs transfer pricing.¹⁵¹ The RPS entities jointly created Nortel’s IP through their combined R&D efforts. They are therefore entitled to share in the benefits of that IP, and any transfer pricing method must compensate them fully, at an arm’s length price for their efforts. Nortel determined that the best way to do so was by giving each party an economic interest in proportion to its R&D spending.

93. Kerry Stephens was a consultant for NNUK regarding tax matters and had been a partner at PricewaterhouseCoopers specializing in transfer pricing.¹⁵² His view, like that of Mr. Gatley, is that Nortel’s IP “was economically owned, for which one might read beneficially owned, by the [Residual Profit Split Methodology] participants.”¹⁵³ This ownership interest arose because

¹⁵⁰ J. Gatley Tr. 252:9–253:8, Nov. 7, 2013 (emphases added); *see also id.* at 253:10–254:6 (“My dad buys a car. It’s a piece of junk. And he spent a thousand dollars on it. And I spent my weekends fixing the car up for a year. At the end of the year, he says, ‘Guess what, I’m selling the car for \$10,000 to the neighbour. I just made \$9,000 profit.’ Well, he owned the car. He had the legal title to it. He sold it. He’s totally entitled to the proceeds, because he is legally the owner. But it’s not fair to me because I spent a lot of time and effort during the course of that year helping fix that car up. So that’s the economic interest that I am referring to. I have an economic interest in the car and the proceeds of it because I was the one that increased the value of it.”).

¹⁵¹ *Cf., e.g.,* Cooper Allocation Report 10 (noting that “[t]he result of properly functioning transfer pricing arrangements is that income is recorded in the appropriate legal entity based on what that legal entity would have earned had it participated in the activities in question purely on an arm’s length basis”).

¹⁵² *See* K. Stephens Tr. 26:23–28:14, Nov. 7, 2013.

¹⁵³ K. Stephens Tr. 56:6–16, Nov. 7, 2013.

“they share the profits on a basis and therefore that must represent some element of ownership, and they contribute to the creation of the asset and share in the fruits of it.”¹⁵⁴

94. The testimony of Philippe Albert-Lebrun, the financial controller for NNSA at the time the Master R&D Agreement was introduced, was compelling on this point.¹⁵⁵ NNSA performed disproportionately high R&D as compared to its revenues.¹⁵⁶ Under the Cost Sharing Agreement it had been reimbursed for that R&D spending; however, under the Master R&D Agreement, not only would NNSA not be reimbursed for its R&D spending, it also would have to make additional transfer payments on account of its significant share of Nortel’s overall losses under the Residual Profit Split Methodology.¹⁵⁷ Mr. Albert-Lebrun was initially concerned that the Master R&D Agreement, which would confirm the implementation of the Residual Profit Split Methodology, was not in NNSA’s best interests.¹⁵⁸ The reason he ultimately concluded that NNSA could agree to the Master R&D Agreement was that NNSA would have an economic interest in Nortel IP based on its contributions to R&D:

¹⁵⁴ K. Stephens Tr. 56:13–57:2, Nov. 7, 2013; *see* Stephens Aff. ¶ 20 (“In other words, I had understood that the RPSM participants owned Nortel’s intellectual property and were entitled to receive the economic benefits from exploiting it in proportion to their relative contributions to the creation of that intellectual property. Those contributions were measured by the participants’ relative share of R&D spending over time and this in turn dictated how much profit or loss each participant made. This economic ownership was the basis on which we could represent to the tax authorities that each RPE was entitled to share in the profits and losses of the Nortel Group.”); *see also* J. Doolittle Tr. 116:18–117:15, Dec. 5, 2013 (explaining that Nortel’s Residual Profit Split Methodology allocated profits and losses based on capitalized R&D); G. Sparagna Tr. 245:14–247:23, Dec. 10, 2013 (explaining allocation in accordance with beneficial ownership).

¹⁵⁵ *See* P. Albert-Lebrun Tr. 30:5–12, Nov. 21, 2013 (noting his position as controller of NNSA in 2003).

¹⁵⁶ Albert-Lebrun Aff. ¶ 16.

¹⁵⁷ Albert-Lebrun Aff. ¶ 16.

¹⁵⁸ Albert-Lebrun Aff. ¶ 16–19.

My understanding was that NNSA would continue to have an economic interest in any resulting IP arising from NNSA's R&D efforts and investment and that NNSA would retain a shared right to benefit from Nortel's IP in the future. Economic ownership signified to me that NNSA would have an entrepreneurial right to the future benefits that could be derived from Nortel's operations and, indeed, if a business was sold then it would have a right to share in the proceeds. It also meant that NNSA would share in the downside risks by sharing in any losses that were suffered by the Group. It was never suggested to me that NNSA would be giving up any of its rights to IP nor that it was limited under the RPSM to sharing the profits and losses of the whole Group without any potential future upside in the IP.¹⁵⁹

95. In summary, Nortel consistently acted on the basis that the RPS entities were joint owners of the IP by virtue of their contributions to the R&D that created the IP. Only the EMEA Debtors' contribution theory is consistent with Nortel's historical practices and representations.

4. *Allocation of Proceeds from the UMTS Sale to Alcatel*

96. In Nortel's largest prepetition asset sale, Nortel allocated proceeds attributable to IP in proportion to relative contributions as measured by R&D spending, consistent with the EMEA Debtors' contribution theory, and not in accordance with the allocation theories proposed by the U.S. or Canadian Debtors.

¹⁵⁹ Albert-Lebrun Aff. ¶ 19; *see also id.* ¶¶ 20–24; NNSA Functional Analysis for the Years Ended December 31, 2000–2004, at 6–7, 99–100 (Ex. TR48763); Nortel Networks S.A. Transfer Pricing – Meeting with French Tax Authorities, at 19, 26 (Mar. 9, 2006) (Ex. TR31120) (noting that “[s]haring in profits allows NNSA to benefit from Nortel's global R&D efforts,” “RPS will benefit NNSA in the long term,” “NNSA is an entrepreneur,” and “NNSA bears the risks associated with its activities and may incur losses if such risks materialize”); *cf.* C. Rogeau Tr. 55:14–56:9, Dec. 12, 2013 (explaining his belief that NNSA was entitled to proceeds from divestiture of Nortel business).

97. In December 2006, Nortel sold its UMTS business to Alcatel.¹⁶⁰ UMTS was a 3G wireless technology primarily used in Europe and Asia-Pacific.¹⁶¹ Nortel’s R&D for the UMTS business had been based in France.¹⁶² As Nortel’s first divestiture of a business that occurred while the Master R&D Agreement was in effect, this transaction is a significant precedent for the postpetition asset sales at the center of this allocation dispute.¹⁶³

98. The Asset Sale Agreement with Alcatel gave Alcatel the right – subject to Nortel’s objection – to determine how the purchase price would be allocated to various classes of assets for financial reporting purposes, subject to the requirement that tangible assets (owned equipment and inventory) were valued based on Nortel’s net book value.¹⁶⁴ Alcatel allocated the price between four asset classes: tangible assets, customer relationships, IP, and a residual

¹⁶⁰ DSC Appraisal Assocs., Alcatel Valuation of Certain Assets of Nortel Networks’ UMTS Business as of December 31, 2006, at 2 (Feb. 12, 2007), NNI_00174638 at NNI_00174645 (Ex. TR47016).

¹⁶¹ G. Riedel Tr. 41:2–3, 141:5–17, Oct. 10, 2013; *see also* DSC Appraisal Assocs., Alcatel Valuation of Certain Assets of Nortel Networks’ UMTS Business as of December 31, 2006, at 2 (Feb. 12, 2007), NNI_00174638 at NNI_00174645 (Ex. TR47016) (describing how Alcatel would “significantly reinforce its presence” in Europe and Asia-Pacific through the acquisition).

¹⁶² G. Riedel Tr. 44:5–17, Oct. 10, 2013 (describing how Alcatel was interested in Nortel’s UMTS business because “the UMTS business, the principal development and management was done in France and that was seen as an attractive dimension of the business”); *see also id.* 107:13–108:11 (discussing how R&D for the UMTS business was carried out in Chateaufort, France).

¹⁶³ *See* Email from Kerry Stephens, Tax Dep’t, EMEA, to Michael Orlando, Int’l Tax-Transfer Pricing, NNI, et al. (Nov. 6, 2006, 8:44 a.m.), EMEAPRIV0204736 at EMEAPRIV0204736 (Ex. TR41275) (“We will be confronted, in practice I think for the first time with a global disposal of IP arising under the master agreement.”).

¹⁶⁴ Share and Asset Sale Agreement between Nortel and Alcatel Lucent, Ex. 2.2.7(i), (ii), at NNC-NNL06026778/57–58 (Ex. TR31585); *see also* K. Stephens Tr. 63:11–20, Nov. 7, 2013 (discussing how, for the intangible assets, “the purchaser had the right to allocate the consideration over asset classes”); Memorandum from the Nortel Global Initiatives Group to the Project Osiris Files, at 1 (Feb. 15, 2007), at NNC-NNL06031298/1 (Ex. TR11260) (“Alcatel had right to allocate intangible consideration over asset categories . . .”).

goodwill category, and Nortel accepted this allocation.¹⁶⁵ Nortel then had the discretion to allocate the proceeds attributable to each of these four categories among the various Nortel entities that had been involved in the business that was sold.¹⁶⁶

99. Nortel allocated sale proceeds attributable to IP based on the sellers' respective R&D contributions, which is consistent only with the EMEA Debtors' position in this dispute.¹⁶⁷ Nortel's senior executives, such as EMEA's Kerry Stephens and NNI's Mark Weisz and Michael Orlando,¹⁶⁸ recognized that the parties' underlying economic ownership of the IP must drive the allocation of sale proceeds.¹⁶⁹

¹⁶⁵ See Stephens Aff. ¶ 27; Memorandum from the Nortel Global Initiatives Group to the Project Osiris Files, at 1 (Feb. 15, 2007), at NNC-NNL06031298/1 (Ex. TR11260).

¹⁶⁶ Stephens Aff. ¶ 28 (“While the purchaser had the right to allocate the purchase price across the various asset classes, Nortel had the right to allocate the consideration by asset class to each selling entity within the Nortel Group as it deemed appropriate.”); Nortel/Alcatel Purchase Price Allocation Asset Allocation Statement (July 24, 2007), NNI_00286115 (Ex. TR31560) (allocating value across Nortel entities from fixed assets, inventory, customer relationship intangibles, IP, and goodwill).

¹⁶⁷ Stephens Aff. ¶¶ 43–45.

¹⁶⁸ M. Weisz Tr. 139:23–140:24, Nov. 25, 2013 (discussing how the Master R&D Agreement “doesn’t address how to deal with this issue”); Stephens Aff. ¶ 48 (“The third addendum made it clear that the total profits or losses from the sale of a Nortel business should not automatically be treated as operating profits or losses for purposes of the formula for determining the residual profits to be allocated among the Nortel entities under the MRDA. Although this was only clarified in the third addendum, it has been in practice since 2001 and was accepted by all parties in the transfer pricing calculations. Consistent with this, the proceeds of the UMTS sale had been excluded from the 2006 RPSM calculations. . . . Once the proceeds had been divided by asset class, it was only the value attributable to intellectual property that was allocated in accordance with the then-prevailing RPS percentages.”); M. Orlando Tr. 161:25–162:12, Nov. 5, 2013 (agreeing that “[w]hile NNL generally is the legal owner of the technology, the master R&D agreement determines the economic ownership of it, and, thus, allocation of the consideration by proportionate R&D capital stock is appropriate”); see also J. Doolittle Tr. 191:15–192:3, Dec. 5, 2013 (agreeing that sale proceeds in respect of IP were allocated based on the RPS entities’ respective R&D contributions, despite the fact that the Master R&D Agreement does not govern the allocation of sale proceeds).

¹⁶⁹ K. Stephens Tr. 67:14–68:22, Nov. 7, 2013 (explaining that the allocation approach was correct because “the RPSM participants owned and had the rights to that technology and they should get the proceeds”); Memorandum from the Nortel Global Initiatives Group to the Project Osiris Files, at 2 (Feb. 15, 2007), at NNC-NNL06031298/2 (Ex. TR11260) (“While NNL generally is the legal owner of the technology, the Master R&D Agreement determines the economic ownership of it and thus allocation of the consideration

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100. NNI tax lawyer Louis Farr explained to the company's auditors at the time that the value of IP sold to Alcatel should be distributed in accordance with the underlying economic ownership of the RPS entities:

The value for IPR was allocated using RPS percentages. RPS determines how profits and losses are shared. If UMTS access was not sold, all of the RPS members would share profits and losses associated with the business. Since RPS determines the economic relationships between the parties, all rights associated with the IPR should be shared based on RPS percentages. This is also consistent with Nortel's view that all Nortel IPR is indistinguishable such that all value should be shared among the RPS members.¹⁷⁰

101. Nortel used the Residual Profit Split Methodology percentages then in place as the measure of R&D contributions in order to apportion the proceeds of the UMTS sale that were attributable to IP.¹⁷¹ This was consistent with viewing a sale of assets as simply capitalizing a future stream of income:

Again I cannot recall the basis on which the original allocation was made, but it seemed to us in Europe that **the only logical answer was RPS ratio, that the RPSM participants owned and had the**

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by proportionate R&D Capital Stock is appropriate.”); Email from Michael Orlando, Int’l Tax-Transfer Pricing, NNI, to Rosanne Culina, IC-Fin. Tax, NNL, et al. (Feb. 15, 2007, 9:52 p.m.), at NNC-NNL06031297/1 (Ex. TR11260) (stating that Mr. Weisz reviewed this memorandum); *see also* Albert-Lebrun Aff. ¶ 34 (“I understood at the time that the rationale for this method was that the RPSM reflected the participants’ underlying ownership rights to Nortel’s intellectual property, which I had understood to amount to ‘economic’ ownership.”).

¹⁷⁰ Email from Louis Farr, Tax Dep’t, NNI, to Timothy Pickering, Int’l Tax, Deloitte & Touche LLP, et al. (Jan. 29, 2007, 2:25 p.m.) (Ex. TR11259) (emphases added); *see also* Agreement with Respect to Certain NN Technology at 2 (Dec. 30, 2006) (Ex. TR21148) (stating in the second recital that the UMTS business was “beneficially owned by the Participants in their respective Territories in accordance with the terms of the Master R&D Agreement”).

¹⁷¹ Stephens Aff. ¶ 48 (stating that IP value “was allocated in accordance with the then-prevailing RPS percentages”).

rights to that technology and they should get the proceeds, and the best measure of that was current RPS ratio. Again, as I said earlier, that’s a receipt today of something you might have got over the next ten years. . . . [I]n my view they had the economic interest as reflected by their sharing in the fruits of that technology. **As I say, the fact it was received today rather than in ten years, that should not change the principle that belongs to those who have contributed to it.**¹⁷²

102. Nortel measured R&D spending according to the 30% declining balance method used under the Master R&D Agreement between 2001 and 2005.¹⁷³ Significantly, as noted above, the Third Addendum entered into at the end of 2008 amended this to a straight five-year “look back” effective as of January 1, 2006, before the UMTS sale to Alcatel.¹⁷⁴

103. Other asset categories in the UMTS sale were also distributed in a manner consistent with the underlying ownership. Tangible assets were assigned their book value and allocated to their owners as indicated in Nortel’s books and records.¹⁷⁵ Substantial value was assigned to customers and was allocated in proportion to each Nortel entity’s share of external customer revenue from the UMTS business.¹⁷⁶

¹⁷² K. Stephens Tr. 67:19–68:3, 68:16–22, Nov. 7, 2013 (emphasis added); *see also* R. Culina Tr. 67:13–68:5, Oct. 17, 2013 (“[I]f we were an ongoing business, each of these RPS entities were getting a share of the proceeds or a share of the operating profits or losses, whatever it had been. . . . And we would have allocated to each of them in accordance with the capital stock, the R&D capital stock, so the methodology within the RPS. So I think that what we did then was apply that same methodology to the sale proceeds.”).

¹⁷³ Cooper Allocation Report 21–22.

¹⁷⁴ Third Addendum to Master R&D Agreement sched. A, NNC-NNL06001514/49 (Ex. TR21003).

¹⁷⁵ Stephens Aff. ¶ 39 (stating that tangible assets “were to be allocated at book value”); Memorandum from the Nortel Global Initiatives Group to the Project Osiris Files, at 1 (Feb. 15, 2007), at NNC-NNL06031298/1 (Ex. 11260) (“Tangible assets to the owner at US GAAP book”).

¹⁷⁶ Nortel Networks, Sale of UMTS Access Business to Alcatel Lucent, Allocation of Consideration, at EMEAPROD1305281 (Ex. TR43287) (“Customer contract consideration was allocated pro rata to external

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5. *Project Swift*

104. In December 2007, NNL sold certain of its subsidiaries to NNUK as part of a transaction known as “Project Swift.”¹⁷⁷ In connection with Project Swift, Ernst & Young UK conducted a valuation of the subsidiaries that were to be sold.¹⁷⁸ The valuation that Ernst & Young UK conducted was considered in relation to the purchase price that NNUK ultimately paid for the subsidiaries it acquired from NNL.¹⁷⁹

105. On December 18, 2007, Ernst & Young UK provided a report known as the “Project Eagle” report, which assessed the value of the subsidiaries to be sold to NNUK on both a going concern basis (assuming the solvency of the Nortel enterprise) and an insolvency basis (assuming a groupwide Nortel insolvency).¹⁸⁰

106. The Project Eagle report explicitly recognized that NNUK and certain of the subsidiaries expected to be transferred had beneficial ownership rights that entitled them to a share of the value of NN Technology.¹⁸¹ The report noted that “[w]hilst legal ownership of the NN Technology is with NNL, beneficial ownership is shared across various group

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customer revenues for the 2006 [sic] by reference to the Nortel entity that had the true customer relationship.”).

¹⁷⁷ Ernst & Young Transaction Advisory Services – Project Eagle, at 7–8 (Dec. 18, 2007), EMEAPROD2052817 (Ex. TR11123) [hereinafter “Project Eagle Report”].

¹⁷⁸ Project Eagle Report at EMEAPROD2052818–19 (Ex. TR11123).

¹⁷⁹ Project Eagle Report at EMEAPROD2052818–19 (Ex. TR11123).

¹⁸⁰ Project Eagle Report at EMEAPROD2052819 (Ex. TR11123).

¹⁸¹ The Project Eagle report defined “NN Technology” as “Intellectual Property and relevant intangible assets as defined in the Group’s Master Research and Development Agreement.” Project Eagle Report at EMEAPROD2052822 (Ex. TR11123).

companies.”¹⁸² Indeed, one of the report’s key assumptions was that, in an insolvency scenario, “[v]alue attributable to the NN Technology (treated as an asset realisation) is apportioned across the Group.”¹⁸³ The valuation of the Project Swift transaction was therefore premised on the explicit assumption that the Nortel entities had joint beneficial ownership of Nortel’s IP.

F. Nortel Allocated The Proceeds Of Patent Litigation In Accordance With The Contribution Approach.

107. In 2004, Nortel settled patent infringement claims against Foundry for \$8 million in respect of past infringement and \$27 million for prospective royalties.¹⁸⁴ The parties shared the proceeds of the Foundry settlement in proportion to their R&D contributions.¹⁸⁵ [REDACTED]

[REDACTED]

¹⁸² Project Eagle Report at 37 (Dec. 18, 2007) (Ex. TR11123).

¹⁸³ Project Eagle Report at 4 (Dec. 18, 2007) (Ex. TR11123).

¹⁸⁴ See Email from Louis Farr, Tax Dep’t, NNI, to Laurie Krebs, Tax Dep’t, NNI, et al. (Jan. 13, 2005, 12:13 p.m.), at NNC-NNL11029235/1 (Ex. TR21167).

¹⁸⁵ See Email from Louis Farr, Tax Dep’t, NNI, to Laurie Krebs, Tax Dep’t, NNI, et al. (Jan. 13, 2005, 12:13 p.m.), at NNC-NNL11029235/2 (Ex. TR21167).

¹⁸⁶ Nortel Networks/Foundry Networks Confidential License Agreement at 1 (first recital) (Oct. 25, 2004), at NNC-NNL11029237/1 (Ex. TR21167) (emphasis added).

¹⁸⁷ See Nortel Networks/Foundry Networks Confidential License Agreement, attach. 1 (Oct. 25, 2004), at NNC-NNL11029237/14 (Ex. TR21167) [REDACTED] Global IP Law Group, Issued Patents and Pending Patent Applications Asset List (Apr. 15, 2010) (Ex. TR22113) [REDACTED]

[REDACTED] Malackowski Report,

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G. Nortel’s Postpetition Conduct Confirmed The Beneficial Ownership Rights Of The RPS Entities To Nortel IP.

108. Even after Nortel’s insolvency, the company continued to act and make representations to tax authorities in a manner that was consistent only with joint ownership and the allocation theory advanced here by the EMEA Debtors. For example, with respect to the Business Sales, the Canadian Monitor prepared internal purchase price allocations (“PPAs”) that allocated the proceeds of sale among the various Nortel entities for financial reporting purposes.¹⁸⁸ These PPAs allocated IP sale proceeds in proportion to R&D contributions, just as had happened under the UMTS sale.¹⁸⁹ John Doolittle, NNL’s CFO, summarized the company’s decision to use a contribution approach as follows:

Q. [A]fter consulting with the Monitor, legal counsel and the auditors, the decision was made ultimately by you, sir, that the **proceeds of the sale of intellectual property in the post-bankruptcy sales would be allocated for the purposes of NNL’s financial statements according to the R&D contribution calculations under the Master Research and Development Agreement, sir?**

A. I would say that there was a consistent view that that was the way that we should file it, and I supported that.¹⁹⁰

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app. O (noting that Rockstar or its subsidiaries have asserted Patent No. 5,732,080 against Cisco Systems, Inc. and Patent No. 6,192,397 against Charter Communications Inc.).

¹⁸⁸ See, e.g., Email from Michael Orlando, Tax Dep’t-Transfer Pricing, NNI, to David Chapman, et al. (Sept. 28, 2010 12:55 p.m.), at NNI_01432896 (Ex. TR11264) (circulating draft PPAs for four Business Sales).

¹⁸⁹ Email from Michael Orlando, Tax Dep’t-Transfer Pricing, NNI, to David Chapman, et al. (Sept. 28, 2010 12:55 p.m.), at NNI_01432903–05 (Ex. TR11264) (attaching draft PPAs for each of the Alteon, Packet Core, CDMA, and Enterprise sales showing that “Intellectual Property/Other residual” assets would be “[a]llocate[d] to RPS entities based on R&D capital stock %”).

¹⁹⁰ Doolittle Tr. 201:21–202:7, Dec. 5, 2013 (emphasis added).

109. In summary, Nortel personnel responsible for dealing with Nortel's IP and implementing Nortel's business arrangements understood that the RPS entities owned the IP. They represented to tax authorities that the RPS entities owned the IP. They drafted numerous provisions of the Master R&D Agreement and its various addenda that recognized and were premised on the fact that the RPS entities owned the IP. They allocated sale proceeds and the proceeds of litigation in a manner that was consistent only with joint ownership in proportion to R&D spending. And yet today, the EMEA Debtors are the only party that still advocates allocating sale proceeds in proportion to R&D spending.

H. Proceeds Attributable To IP Should Be Allocated Based On Relative R&D Spending Over The Period When The IP Was Created.

110. The EMEA Debtors submit that the relative contributions of the RPS entities to the creation of Nortel's IP should be determined according to their proportional R&D spending over the period when the IP that was sold in the Business Sales and the Residual Patent Sale had been created. The use of costs to measure the relative value of contributions to the creation of an intangible asset is in accordance with equitable principles as well as the Residual Profit Split Methodology applied by Nortel before the insolvency filings, as is the reliance on data for costs expended over the period when commercially valuable IP was created, *i.e.*, the useful (or economic) life of the IP.¹⁹¹

¹⁹¹ The logic of this is obvious. New technologies will eventually become obsolete, so the time period when IP can be commercially exploited is limited. Dollars spent on R&D during the period when the commercially valuable IP was developed contributed to the value of that IP, and therefore, to the profits currently being earned. On the other hand, dollars spent on R&D before today's commercially valuable IP was developed do not provide any current value, and should not entitle an entity to a share of the profits.

111. Unless an intangible asset has actually been sold, establishing economic life is generally an exercise in estimation. Indeed, the Canadian Debtors’ transfer pricing expert, Timothy Reichert, refers to it as a “black art” that will generally depend on “experience, judgment and ultimately subjectivity.”¹⁹² It must nevertheless be based on actual commercial life. The formula that Nortel put in place just before these insolvency proceedings was based on the assumption that the entire pool of Nortel’s IP had a useful life of only five years.¹⁹³ Regardless of how the Group arrived at this figure or whether it was arrived at in good faith, it is beyond dispute that five years represent a gross underestimate of the actual useful life of most of Nortel’s IP.¹⁹⁴ The IP that was included in the Business Sales and the Residual Patent Sale dated back to 1992 – considerably longer than five years.¹⁹⁵

112. The fact that Nortel’s IP has now been sold means that it would be an error to rely on an incorrect prior estimate of useful life in order to determine how to allocate proceeds attributable to the value of Nortel’s IP. This is because the sale of the IP provides objective proof that the useful or economic life of the IP is no less than the period from its date of creation to the date of the sale. The hallmark of economic life is that the IP is still saleable. If an independent party is willing to purchase an intangible asset, the intangible is *ipso facto* still within its economic life, because economic life does not come to an end until “a third party would be unwilling to pay for

¹⁹² Timothy Reichert, “Introducing the Profit Vintages Method: A New Model for Valuing and Decomposing the Enterprise,” Draft Chapter 1 in *How to Define and Value Goodwill*, at 4 (Ex. TR40748).

¹⁹³ As discussed below, from 2006 to 2008, Nortel applied a flat five year period. For the period 2001 to 2005, Nortel applied a 30% annual amortization rate.

¹⁹⁴ *Cf.* Malackowski Rebuttal 30–31.

¹⁹⁵ *See* Malackowski Report 41.

access to the intangible.”¹⁹⁶ As the Canadian Debtors’ transfer pricing expert has written, the “most objective” approach to determining useful life is by reference to “commercial transferability” – *i.e.*, whether an independent party is willing to purchase the intangible.¹⁹⁷ Where actual, objective market data is available, the arm’s length principle requires that it be utilized in allocating a group’s revenues.¹⁹⁸

113. The EMEA Debtors’ IP expert, James Malackowski, has provided a detailed analysis of the useful life of the IP that was included in each of the Business Sales and in the Residual Patent Sale.¹⁹⁹ This data should be relied upon to allocate the proceeds of the asset sales.

114. Mr. Malackowski’s findings about the lengthy useful life of the IP conveyed in the asset sales is consistent with other available evidence. Although product-specific technology is often obsolete as soon as the product is, advanced research that results in entirely new technology (or that patents a field occupied by a competitor) can be relevant through the entire twenty-year life of a typical patent. As a leading NNUK engineer has explained, “foundational patents are more likely to have and retain their value longer (relative to other patents in that particular field)

¹⁹⁶ Timothy Reichert, *On the Meaning of (Economic) Life: An Overview and Proposed Method of Estimation 5* (draft 2014) (Ex. TR40710); *see also* T. Reichert Tr. 229:9–13, Mar. 20, 2014 (“Q. And as I understand it, a sale of a portfolio of IP indicates that the IP is still useful. A. Hmm, perhaps not in the making and selling of NN products, but yes, certainly.”).

¹⁹⁷ Timothy Reichert, *On the Meaning of (Economic) Life: An Overview and Proposed Method of Estimation 5* (draft 2014) (Ex. TR40710); T. Reichert Tr. 229:2–230:6, Mar. 20, 2014 (agreeing that the sale of IP in the Rockstar transaction is strong evidence that the IP was still within its useful life at the time of sale).

¹⁹⁸ *See* Expert Report of Steven D. Felgran 7–8 (Jan. 24, 2014) (“The guiding principle of the selection of a transfer pricing method is reliability of the results, *i.e.*, whether the results of the transfer pricing method reflect the economic reality given the information *currently* available. . . . [I]n some cases, *ex post* adjustments are required.”).

¹⁹⁹ Malackowski Report 39–44; Malackowski Rebuttal 27–32.

because of the intrinsic breadth of their claims, and for example their concomitant opportunities for subsequent divisional filings, worldwide filings and reissuance of claims.”²⁰⁰ In other words, the broader and more foundational a patent, the greater its value and the longer its useful life.²⁰¹

115. The most valuable patents in Nortel’s portfolio tended overwhelmingly to be at least ten years old.²⁰² For example, beginning as early as 1998, Nortel began work on wireless technology that would eventually be incorporated into various wireless products, including the current 4G LTE standard. It took seven to eight years for LTE to even enter the market. According to one of the Canadian Debtors’ witnesses, this kind of timeline was “very common” at Nortel.²⁰³

116. There are numerous practical reasons why the useful life of Nortel’s IP tended to be longer than five years. For starters, it typically takes three to four years for a patent application to become an issued patent.²⁰⁴ Even if one assumes only a year of R&D before filing a patent, this results in a lag of four to five years between R&D work and an issued patent. Even after a patent is issued, it can typically take many years before products incorporating that technology are adopted by the market. As Mr. Malackowski explained, “many technologies are adopted by the market slowly over time and do not realize their full value until later in the life of the

²⁰⁰ Brueckheimer Aff. ¶ 29.

²⁰¹ Tucker Report ¶¶ 23–24, 63–65.

²⁰² Malackowski Report 41, fig.1.

²⁰³ McFadden Tr. 42:10–43:8, 45:7–46:19, Oct. 21, 2013.

²⁰⁴ Malackowski Rebuttal 27.

patent.”²⁰⁵ As a result, many Nortel technologies only reached peak market adoption (and therefore market value in terms of potential revenue) ten or even twenty years after the patent was filed.²⁰⁶ In addition, some of the most valuable patents covered basic wireless communication standards that, while initially developed for 2G technology, have since been incorporated as building blocks in 3G and 4G phones.²⁰⁷ Similar stories can be told for other technologies. These older “building block” patents were among the most valuable in Nortel’s portfolio.²⁰⁸

117. Among the one- and two-star patents identified by Global IP as part of the preparation for the Residual Patent Sale, none was filed after 2007, and the majority were filed before 2000.²⁰⁹ The same pattern also prevailed for patents sold in the Business Line Sales.²¹⁰ Far from being obsolete, IP five years or older was just starting to gain value and was typically many years from peaking in value.

²⁰⁵ Malackowski Rebuttal 28.

²⁰⁶ *See* Malackowski Rebuttal 29 fig.6; Newcombe Aff. ¶¶ 19–22; Brueckheimer Aff. ¶¶ 29–30.

²⁰⁷ *See* Jeffries Aff. ¶ 34 (“Our research contributed to product development on a number of international standards for mobile communications including the Global System for Mobile communications (‘GSM’), a global second generation (‘2G’) mobile phone standard, Universal Mobile Telecommunications System (‘UMTS’), which was a global ‘3G’ standard, and newer 4G standards such as Worldwide Interoperability for Microwave Access (‘WiMAX’) and Long Term Evolution (‘LTE’) or (‘4G’) in the UK as well as other wireless products including backhaul and Wi-Fi.”).

²⁰⁸ *See* Brueckheimer Aff. ¶ 29 (“In my experience, foundational patents are more likely to have and retain their value longer (relative to other patents in that particular field) because of the intrinsic breadth of their claims, and for example, their concomitant opportunities for subsequent divisional filings, worldwide filings and reissuance of claims.”).

²⁰⁹ Malackowski Report 41; Malackowski Rebuttal 30–31.

²¹⁰ *See* Malackowski Rebuttal 30.

118. The long useful life of Nortel’s IP is also borne out in the company’s patent maintenance practices. In the United States, patent maintenance payments are due 3.5 years, 7.5 years, and 11.5 years after issuance, with fees doubling for each of the latter two installments.²¹¹ If patents have no value, there is no reason to make these maintenance payments, and Nortel’s policy was to “cull” its patent portfolio regularly.²¹² However, the majority of the patent portfolios in the Business Sales were more than 7.5 years old, with many being over 11.5 years old.²¹³ Tellingly, in the Residual Patent portfolio, the proportion of older patents was even higher among those patents designated with one or two stars by Global IP.²¹⁴ While 64.0% of all residual patents sold were older than 7.5 years and 37.4% were older than 11.5 years, 95.4% of high-interest residual patents were older than 7.5 years, and 64.8% of these patents were older than 11.5 years.²¹⁵ These statistics indicate that a substantial proportion of Nortel’s valuable patents – and particularly the highest value patents – were over 7.5 years old notwithstanding the higher maintenance payments associated with patents of that age.²¹⁶ Of eleven patent infringement suits launched by the Rockstar Consortium or its members, the average filing date for patents asserted was between 1996 and 2000 – *i.e.*, at least eleven years old at the time of the Residual Patent Sale.²¹⁷

²¹¹ See Malackowski Rebuttal 30.

²¹² See Anderson Reply Aff. ¶ 24 (describing Nortel’s “continuous process of ‘culling’ patents” to identify any redundant or unused IP that Nortel “could stop paying to maintain”).

²¹³ Malackowski Rebuttal 30.

²¹⁴ Malackowski Report 41; Malackowski Rebuttal 30–31.

²¹⁵ Malackowski Rebuttal 31.

²¹⁶ See Malackowski Rebuttal 30–31.

²¹⁷ Malackowski Rebuttal 31–32.

119. Notwithstanding all the reasons why advanced technology patents like those held by Nortel had a very long useful life, for tax reasons Nortel had a strong incentive to amortize its R&D as quickly as possible. Generous Canadian R&D tax credits reduced Nortel’s effective tax rate in that country.²¹⁸ Nortel therefore had an incentive to maximize accounting profits in Canada. At the time that the Residual Profit Split Methodology was adopted, the company anticipated NNL performing a higher percentage of R&D than it had historically.²¹⁹ As a result, an amortization method that discounted historical R&D spending in favor of more recent or future spending would maximize profits to Canada and minimize overall tax burden.²²⁰ This gave Nortel a strong incentive to amortize R&D as quickly as possible.

120. Because the R&D capital stock was amortized over the “useful life” of the resulting IP, the number of years assumed for the IP’s “useful life” directly impacted the allocation of residual profits or losses.²²¹ If the amortization rate was high, meaning the useful life was short, historical R&D spending would be discounted from the R&D capital stock more rapidly.²²² In contrast, if the amortization rate was low (meaning the useful life was long), the historical R&D spending would be discounted from the R&D capital stock more slowly²²³:

We anticipated that during the term of the APA, R&D increasingly would be performed by NNL, and NNL’s proportion of R&D spending relative to the total spending of the group would increase.

²¹⁸ Henderson Decl. ¶¶ 40–42.

²¹⁹ Henderson Decl. ¶ 52.

²²⁰ Henderson Decl. ¶ 52.

²²¹ Henderson Decl. ¶ 51.

²²² Henderson Decl. ¶ 51.

²²³ Henderson Decl. ¶ 51.

Therefore, **using a higher amortization rate would result in a larger R&D capital stock balance for NNL – and thus a greater share of the residual profits – more quickly than would occur assuming a longer useful life**, because the calculation of R&D capital stock would be weighted towards future, rather than historical, R&D spending.²²⁴

121. It is therefore not surprising that under the Master R&D Agreement, Nortel initially adopted a declining balance amortization rate of 30% per annum for its R&D capital stocks, which reduced R&D capital stocks to 5% of their original value within nine years.²²⁵ Later, on the verge of insolvency, the company adopted a straight “look back” period of five years.²²⁶

122. While these aggressive amortization schedules may have been tax efficient for Nortel and may appear to be consistent with the rapid obsolescence of modern technology with which any consumer is familiar, it was not consistent with the way IP actually works at an advanced technology company like Nortel.²²⁷ Catherine Tucker, an economist retained by the U.S. Debtors, explained how “high-technology” patents have a useful life that far outlasts any particular product:

It might be tempting to conclude erroneously that because of the short lifespan of high-technology products, this implies that high-technology research and development investments and the

²²⁴ Henderson Decl. ¶ 52 (emphasis added) (internal citation omitted).

²²⁵ Henderson Decl. ¶ 53; Cooper Allocation Report 21–22; Malackowski Rebuttal 22.

²²⁶ Third Addendum to Master R&D Agreement sched. A, NNC-NNL06001514/49 (Ex. TR21003); *see also* Cooper Allocation Report 22; Malackowski Rebuttal 22.

²²⁷ Similarly, applying postpetition R&D expenditure figures – from 2009 or even later – would not be consistent with Nortel’s operations since following insolvency Nortel did not carry on business in the ordinary course. Instead, its efforts were focused on selling its various businesses, and indeed by the end of 2009 Nortel had “virtually no business operations.” Hamilton Reply Aff. ¶ 9 (discussing NNI’s specific circumstances, which were broadly applicable to all debtors).

associated patent portfolio are more short-lived than in other industries. However, the nature of patent protection given to technology and the way that patents are used actually mean the reverse is the case. **The ability to protect future innovation and use patents as building blocks means that the standard lifetime of research and development and its associated patent portfolio can be far greater than for low-technology patents.**²²⁸

I. The U.S. License Approach, If Adopted, Would Need To Be Revised, And The Canadian License Approach, Being Based Entirely On Incorrect Legal Assumptions, Must Be Rejected.

123. The U.S. Debtors argue that the proceeds of the sales of Nortel's Residual Patent portfolio should be shared based on the value of the licensing rights that each party relinquished.²²⁹ This approach, for all the reasons set out above, does not accord with what the parties owned or how they conducted themselves. It does, however, accord with the licenses actually held by the parties and canceled as a term of the Business Sales and Residual Patent Sale, and is therefore an appropriate approach if the Courts were to conclude that NNL held not just legal title but ownership in its entirety of the IP.

124. The methodology that the U.S. Debtors use to calculate the value of those rights is generally correct: (i) they use a discounted cash flow approach based on the IP Co. model in order to determine the net present value of future cash flows that are likely to be earned from Nortel's Residual Patent portfolio, (ii) they allocate to each of the RPS entities the entire net present value of future cash flows from the residual patent portfolio in their respective territories,

²²⁸ Tucker Report ¶ 35 (Ex. 11396) (emphasis added).

²²⁹ See Expert Report of Jeffrey H. Kinrich ¶¶ 84-87 (Jan. 24, 2014) (Ex. 11432) [hereinafter "Kinrich Report"].

and (iii) they allocate to each of the RPS entities one-fifth of the value of a nonexclusive license to all rest of the world (“ROW”) territories.²³⁰

125. However, the U.S. Debtors’ approach would require some modifications. Most seriously, by adopting Nortel’s IP Co. model without modification, they significantly undervalue the Residual Patent portfolio in jurisdictions outside of North America, asserting that all value exists in Canada, the United States, France, Germany, the United Kingdom, and, in one scenario, China.²³¹ While the majority of residual patents were filed in these jurisdictions, a material number were filed outside of these jurisdictions, particularly in the Asia-Pacific region, where over 20% of patents were designated as high interest by Global IP.²³² When all patent assets are included, the five principal jurisdictions represent less than 80% of the Residual Patent assets.²³³

126. The U.S. Debtors justify their decision not to attribute value to license rights in most of the world by pointing to references discussing the relative strength of the IP regimes in various countries.²³⁴ While these assumptions may not be unreasonable in certain contexts, they are misplaced in the current context of licensing multinational patent portfolios to a series of multinational corporations. The revenues included in the IP Co. Model used as the basis for the U.S. Debtors’ analysis are derived exclusively from multinational corporations, most of which

²³⁰ See Kinrich Report ¶¶ 25, 31, 84, 88. While NNL alone had the right to enforce Nortel IP in the ROW territories, each of the RPS entities held a nonexclusive, sublicensable license to Nortel’s IP, which meant that any one entity could undermine the value of Nortel’s IP in ROW by sublicensing Nortel’s IP to any potential infringer, which reduces to zero the additional value of NNL’s right to enforce. Thus each of the nonexclusive licenses has equal value.

²³¹ See Malackowski Rebuttal 35–37.

²³² Malackowski Rebuttal 34.

²³³ Malackowski Rebuttal 34.

²³⁴ See Kinrich Report ¶¶ 104–10.

have operations in countries such as China, Japan, and South Korea.²³⁵ As Mr. Malackowski explains, it is simply unreasonable to assume that a multinational corporation that negotiates a license to a geographically broad patent portfolio will refuse to pay royalties in select jurisdictions based on their IP regimes.²³⁶

127. Using Mr. Malackowski’s corrected license approach produces the following allocation of value across all Nortel IP sale proceeds²³⁷:

	NNL	NNI	NNUK	NNSA	NNIR
Total Allocated Value	\$596.02	\$2,824.78	\$720.94	\$665.21	\$437.09
Percentage of Total IP Value	11.4%	53.9%	13.7%	12.7%	8.3%

128. The Canadian Debtors concede that the U.S. and EMEA Debtors are entitled to the value of the licenses they relinquished, but they rely on incorrect assumptions about the scope of the licenses and ignore the reality of the way the parties conducted themselves.

129. One particularly noteworthy point is the assumption that the licenses relinquished by the U.S. and EMEA Debtors are limited to currently marketed Nortel products, which means, the Canadian Debtors say, that the licenses do not extend to the residual patents sold to Rockstar.²³⁸

²³⁵ Malackowski Rebuttal 34.

²³⁶ Malackowski Rebuttal 34–35. The U.S. Debtors also make errors in valuing the Business Lines: (i) they determine the “value relinquished by” each debtor group using the historical revenue of the businesses, which is inconsistent with either a fair value or fair market value calculation, both of which would require the determination of the present value of the future benefits that a buyer would obtain through the use of the assets that were sold, and (ii) they apply a single allocation without regard to the various asset classes divested in the Business Sales, which were legally or beneficially owned by the Debtors in various proportions. *See* Malackowski Rebuttal 33.

²³⁷ Malackowski Report 4.

²³⁸ Report of Philip Green Regarding the Allocation of Recoveries Among Nortel Entities 64 (Feb. 28, 2014) [hereinafter “Green Report”]; Berenblut & Cox Report ¶¶ 71, 73.

Thus, 100% of the \$4.5 billion in proceeds from that sale goes to the Canadian entity because it holds legal title.²³⁹ This predicate assumption is not supported by either a plain reading of the license, or even a cursory examination of the record. To give just one example, as mentioned above, when Nortel sued Foundry for patent infringement, many of the patents would later be sold to Rockstar in the Residual Patent Sale.²⁴⁰ Not only was NNI, which the Canadian Debtors now say possessed no license to the patents, included as a party and named as the exclusive licensee,²⁴¹ but the settlement proceeds were also shared among the RPS entities,²⁴² which the Canadian Debtors now say had absolutely no right to the patents whatsoever.

130. Equally implausible is the assumption given to the Canadian experts that the U.S. and EMEA Debtors' licenses were not transferable, which is used to support the very shaky conclusion that the U.S. and EMEA estates are entitled only to the depressed "value in use" of the licenses in Nortel's hands the year before bankruptcy, and not the value of the highest and best use of the licenses, which is the value in the "safe hands" of Business Sale purchasers.²⁴³ As Mr. Malackowski and Mr. Huffard point out, under the Master R&D Agreement the U.S. and EMEA licenses are infinitely sublicensable, which in effect means that they are completely

²³⁹ Green Report 65; Berenblut & Cox Report ¶ 86.

²⁴⁰ See *supra* Section IV.F.

²⁴¹ See, e.g., Complaint, *Nortel Networks Inc. v. Foundry Networks, Inc.*, No. 01-10442DPW, ¶¶ 3, 8, 20, 26, 32, 38 (D. Mass. Mar. 14, 2001) (Ex. TR22084).

²⁴² See Email from Louis Farr, Tax Dep't, NNI, to Laurie Krebs, Tax Dep't, NNI, et al. (Jan. 13, 2005, 12:13 p.m.), at NNC-NNL11029235/2 (Ex. TR21167).

²⁴³ Green Report 4, 25–26, 59; Berenblut & Cox Report ¶¶ 21, 61.

transferrable.²⁴⁴ The Canadians Debtors’ transparently weak attempt to increase the value of the “residual” to which they claim to be entitled as legal title holders must be rejected out of hand.

V. APPROACH TO ALLOCATION OF VALUE
ATTRIBUTABLE TO CUSTOMERS AND GOODWILL

A. The Customer-Related Assets Transferred In The Business Sales Are Separately Identifiable Assets With Significant Value.

131. Although all parties agree that IP is the most valuable asset class transferred in the asset sales,²⁴⁵ the customer-related assets transferred in the Business Sales are separately identifiable assets with significant value.

132. In addition to IP, the purchasers acquired Nortel’s Lines of Business comprised of (i) customer contracts, including anticipated revenue from future opportunities presented by existing customer relationships, (ii) sales, distribution, and customer-support infrastructures, and (iii) active employees who could foster the customer relationships and preserve their value.²⁴⁶ These customer-related assets have significant value, and purchasers paid more in the Business Sales than they would have to just acquire the tangible assets and IP of the Nortel Lines of Business.

133. Customer relationships spanned the Lines of Business and geographic territories. Nortel had an extensive network through which it would service customers locally and transnationally in many significant markets, including Europe.

²⁴⁴ Malackowski Rebuttal 13; Huffard Rebuttal ¶ 29(ii).

²⁴⁵ See, e.g., Huffard Report ¶ 53; Green Report 23.

²⁴⁶ See Huffard Report ¶¶ 69–75.

134. Numerous former Nortel employees testified regarding the importance of customer relationships and Nortel's distribution network.²⁴⁷ For example, John Roesse, who led Nortel's IP practice as chief technology officer, testified that the value of customer relationships was separate from the value of IP:

Q. So does this reflect your view that customer relationships are an extremely valuable asset of the company? A. **In general, customer relationships are an extremely valued asset of any company.** . . . Q. Okay. So your view was it wasn't enough to just be in the market with great technology, correct? A. Yes, absolutely. **If no one knows who you are, great technology goes nowhere.**²⁴⁸

In certain cases a customer relationship held in one region would drive sales in another region.²⁴⁹ Many of Nortel's customers were also global companies, and a relationship in one country could lead to additional sales in another.²⁵⁰ This type of cross-pollination happened in all directions throughout the Nortel group. There is no evidence that any one debtor group had disproportionately more "prime" customer relationships in relation to its overall revenue, and indeed the evidence is that the various debtor groups all had important customer relationships.

²⁴⁷ See, e.g., P. Albert-Lebrun Tr. 46:20–48:18, Nov. 21, 2013 (describing the importance of major customers of NNSA); S. Pusey Tr. 71:16–72:8, Nov. 18, 2013 (describing the importance of major customer relationships as sold along geographic lines); G. Richardson Tr. 57:21–58:9, Oct. 28, 2013 (agreeing that Nortel "always strived" to develop "close relationships" with its customers).

²⁴⁸ J. Roesse Tr. 157:20–159:6, Nov. 11, 2013 (emphases added).

²⁴⁹ Newcombe Aff. ¶ 42.

²⁵⁰ See Newcombe Aff. ¶ 48.

135. Not only did Nortel's former employees recognize that customer relationships were valuable to Nortel, but they also agreed that customer relationships were very valuable to the purchasers of Nortel's businesses.²⁵¹

136. Nortel management also recognized the value of customer relationships to purchasers. Presentations to potential purchasers made in the course of marketing the Lines of Business consistently identified – and emphasized – the importance of customer relationships.²⁵² Many of these significant customers were in the EMEA region, [REDACTED]

[REDACTED]²⁵³

137. In addition, declarations filed with the U.S. Court to approve the Business Sales identified and emphasized the critical importance of value attributable to the customer-related asset class to the ultimate success of the Business Sales:

A significant aspect of the value of the MEN Business is the established relationships the Debtors maintain with hundreds of customers with whom they have entered into the contracts at issue

²⁵¹ M. Zafirovski Tr. 117:12–118:14, Nov. 6, 2013 (stating that “obviously, customers are very important as well” when it came to selling the Nortel business lines); R. Maclean Tr. 22:3–23:17, Oct. 23, 2013 (describing the significant customer relationships and distribution networks Avaya acquired as part of Enterprise sale).

²⁵² See Newcombe Aff. ¶¶ 51–53; CDMA Presentation to MatlinPatterson, at 18–19 (July 7, 2009), NNI_00578024 (Ex. TR47251) (identifying CDMA top customer base by geography and percentage of revenue); Next Generation Packet Core – Project Seville Information Memorandum, at 5, 9–11 (July 31, 2009) (Ex. TR40109) (describing existing customer base by geography); Met[r]o Ethernet Networks, Project Snow, Presentation made to Ekberg, 10, 22 (Mar. 13, 2009) (Ex. TR48683) (discussing customer relationships and growth opportunities); Enterprise Solutions, Presentation made to Narnia, at 5, 10 (Dec. 5, 2008) (Ex. TR47260) (listing customers and revenue by geographic region); Project Equinox Management Presentation, at 85, NNC-NNL06001105 (Ex. TR43850); K. Dadyburjor Tr. 94:15–24, Oct. 3, 2013 (“Q: Am I correct that for at least some of the post-petition business sales, customer assets would have been a material part of what you were selling? A. I think customer assets would always have been an important element in a transaction.”).

²⁵³ See Newcombe Aff. ¶ 51.

in the Sale Motion, in addition to other contracts related to the MEN business but not at issue in the Sale Motion. These Customer Contracts are of critical value not only to any prospective purchaser of the Customer Contracts but also to the Debtors' other businesses.²⁵⁴

138. The purchasers also recognized the value of Nortel's customer-related assets. Former Nortel employees were transferred to the purchasers in order to maintain continuity with customers and capitalize on existing relationships.²⁵⁵ The purchasers also reported in their financial statements that they gained significant value from acquiring Nortel's customer relationships.²⁵⁶

139. The CCC's own allocation expert, Thomas Britven, agrees that customer-related assets should be separately valued and allocated. Mr. Britven identified two categories of identifiable intangible assets: customer relationships and IP.²⁵⁷ Mr. Britven also criticized Philip Green, the Canadian Debtors' allocation expert, for undervaluing the assets transferred by the U.S. and EMEA Debtors.²⁵⁸

²⁵⁴ Declaration of George Riedel ¶ 17, Oct. 7, 2009 [D.I. 1627 Ex. B] (Ex. TR50133).

²⁵⁵ See Huffard Report ¶ 70.

²⁵⁶ E.g., LM Ericsson Telephone Co., Annual Report for the Fiscal Year Ended Dec. 31, 2009 (Form 20-F), at 27 (Apr. 21, 2010) (Ex. TR40195) ("With the acquisition of the Nortel assets for CDMA and LTE, the Company strengthened its ability to serve North America's mobile operators. The acquisition significantly expands Ericsson's footprint in this market, particularly as operators in this region are emerging as early adopters of LTE technology."); Avaya Inc., Annual Report for the Fiscal Year Ended Sept. 30, 2010 (Form 10-K), at 32 (Dec. 7, 2010) (Ex. TR40193) ("The acquisition of NES expands Avaya's technology portfolio, enhances its customer base, broadens its indirect sales channel, and provides greater ability to compete globally.").

²⁵⁷ Thomas Britven, Nortel Networks Expert Report on Valuation and Other Issues Related to the Allocation of Sales Proceeds to the Nortel Debtor Groups ¶ 6.7.

²⁵⁸ Britven Rebuttal ¶ 9.2 ("In our view, Green's treatment of certain asset categories, such as customer relationships, may understate the value of the assets surrendered by [NNI, NNUK, NNSA, and NN Ireland] in the business sales.").

B. Separately Identifying And Assigning Value To Customer-Related Assets Is Consistent With Nortel's Prepetition Practices.

140. Attributing value to customer relationships is consistent with the way Nortel allocated value in respect of this asset class in connection with prepetition asset sales, specifically the sale of the UMTS business to Alcatel. Both Alcatel and Nortel attributed a meaningful portion of the UMTS sale price to customer relationships. Of the \$293 million net purchase price for the UMTS business, \$51.8 million was attributed to customer relationships.²⁵⁹

141. The Nortel entities that sold UMTS assets to Alcatel received allocations on account of customer relationships based on which entity held the primary relationship with various customers.²⁶⁰ Nortel's allocation of the UMTS sale proceeds, including this allocation on account of customer relationships, was audited by Deloitte.²⁶¹

²⁵⁹ Nortel/Alcatel Purchase Price Allocation, Asset Allocation Statement (Dec. 29, 2006), NNI_00432293 (Ex. TR47212) (itemizing, *inter alia*, the divested value of "Customer Contracts" by Nortel entity).

²⁶⁰ Memorandum from the Nortel Global Initiatives Grp. to Project Osiris Files, at 1 (Feb. 15, 2007) (Ex. TR21018) ("Nortel had the right to allocate the sale price amongst vending entities, its determination being on the following basis: . . . Customer contracts by reference to the entities owning the contracts, the allocation being based on proportionate 2006 UMTS revenues."); Email from Louis Farr, Tax Dep't, NNI, to Timothy Pickering, Senior Manager, Int'l Tax, Deloitte & Touche LLP, et al. (Jan. 29, 2007, 2:25 p.m.), BHG0137543 (Ex. TR21160) ("The value of the Customer Relationship Intangible was allocated to those entities that have the face-to-face relationship with the customer. The allocation was based on the revenue that the associated customer contract produces."); Nortel Networks Sale of UMTS Access Business to Alcatel Lucent Allocation of Consideration, at EMEAPROD1305281 (Ex. TR43287) ("Customer contract consideration was allocated pro rata to external customer revenues for the [sic] 2006 by reference to the Nortel entity that had the true customer relationship."); Email from Kerry Stephens, Tax Dep't, EMEA, to Michael Orlando, Int'l Tax-Transfer Pricing, NNI, et al. (Jan. 14, 2007, 9:57 a.m.), EMEAPRIV0034270 (Ex. TR41171) ("The allocation on our part was that customer contract monies were attributed to the entity with the substantive customer relationship, so the UK for example picked up a large share because of the revenues derived from Vodafone and O2.").

²⁶¹ Email from Timothy Pickering, Senior Manager, Int'l Tax, Deloitte & Touche LLP, to Louis Farr, Tax Dep't, NNI, et al. (Jan. 27, 2007, 11:06 a.m.), at NNI_00364700 (Ex. TR11259) ("Please find attached the information that we will require to assist in the audit of this transaction."); Email from Louis Farr, Tax Dep't, NNI, to Timothy Pickering, Senior Manager, Int'l Tax, Deloitte & Touche LLP, et al. (Jan. 29, 2007, 2:25 p.m.), at NNI_00364699 (Ex. TR11259) (responding with detailed information regarding the UMTS

(Footnote continued on next page)

C. Methodology For Allocating The Value Of Customer-Related Assets And Goodwill

142. Consistent with Nortel's prepetition practices, customer-related assets should be treated as an asset class that is separate and distinct from Nortel's IP. The precise valuation and allocation approach that Nortel used prepetition cannot be replicated in this case, however, due to the lack of access to necessary management information. Instead, the EMEA Debtors' allocation expert, Mr. Huffard, allocated the value of customer-related assets and goodwill based on historical revenue attributable to each selling debtor.²⁶²

143. Mr. Huffard grouped customer-related assets with goodwill because the value of both of these asset classes depends on revenues generated by sales to customers.²⁶³ Given the constraints on the information available, the best way to value both of these asset classes is to group customer-related assets and goodwill in a single residual category and allocate the proceeds among the EMEA, U.S., and Canadian Debtors based on revenue.

144. This residual category represents all of the future cash flows from the Business Sales beyond the value that can be directly attributed to the tangible assets, IP, and goodwill associated with IP.²⁶⁴ For the customer-related asset class, the residual value represents the future cash flows from Nortel's existing customer relationships and its distribution network.²⁶⁵ For goodwill

(Footnote continued from previous page)

sale); NNC Annual Report for the Year Ended Dec. 31, 2006 (Form 10-K), at 43, 141 (Mar. 16, 2007) (Ex. TR21139) (including the UMTS sale in Nortel's audited financial statements).

²⁶² Huffard Report App. 9, ¶¶ 12–13.

²⁶³ Huffard Rebuttal ¶ 77.

²⁶⁴ Huffard Report ¶ 115.

²⁶⁵ Huffard Report ¶ 115.

other than goodwill associated with IP, the residual value reflects all other future cash flows that a buyer attributes to the assets that cannot be directly identified.²⁶⁶ Because both of these asset classes should be valued based on revenue, there is no analytical benefit in valuing them separately.²⁶⁷

145. Revenue provides a better valuation key for these assets than other metrics.²⁶⁸ Revenues derived from the fiscal year 2008 are the most representative historical reference available. An earlier reference period would not accurately reflect the anticipated cash flows a Business Sale purchaser would have expected to see. A later reference period would be influenced by Nortel's bankruptcy filing. Accordingly, Mr. Huffard relies on fiscal 2008 revenues to value the residual category – customer-related assets and goodwill.²⁶⁹

146. The table below sets forth the value attributable to the residual asset category and compares it to the total value of each Line of Business sold, demonstrating the substantial value of Nortel's customer-related assets and goodwill.

²⁶⁶ Huffard Report ¶ 115.

²⁶⁷ Huffard Report ¶¶ 94, 115.

²⁶⁸ Huffard Report ¶ 116.

²⁶⁹ Huffard Report ¶ 118.

VALUE OF CUSTOMER-RELATED ASSETS & GOODWILL BY BUSINESS SALE										
		CDMA	Enter- prise	MEN	CVAS	GSM	MSS	Layer 4-7	Next- Gen	Total
Customer- Related Assets & Goodwill	\$ (millions)	865	639	460	67	143	16	7	–	2,198
	% (value)	75.9	67.8	61.7	32.2	59.7	26.0	40.3	–	65.3
Business Value	\$ (millions)	1,140	943	744	207	240	63	18	10	3,365

VI. APPROACH TO ALLOCATION OF VALUE ATTRIBUTABLE TO NET TANGIBLE ASSETS

A. The Net Tangible Asset Class Consists Of Tangible Assets Less Assumed Liabilities.

147. The EMEA Debtors' approach to valuing the tangible assets sold in the Business Sales and allocating the resulting sales proceeds is to combine tangible assets acquired and liabilities assumed by the purchasers into a single asset class known as Net Tangible Assets.²⁷⁰

148. As reflected in the asset sale agreements for the Business Sales, the tangible assets sold generally included monetary assets, inventory, and fixed assets.²⁷¹

149. Monetary assets consisted primarily of certain transferred accounts receivable and prepaid expenses.²⁷² Inventory consisted of raw materials, manufactured and purchased parts, work-in-process, packaging, stores and supplies, related materials, and merchandise that the selling entities maintained as they continued to run their businesses as debtors in possession prior

²⁷⁰ Huffard Report ¶ 61.

²⁷¹ Huffard Report ¶ 62.

²⁷² Huffard Report ¶ 62.

to the completion of the Business Sales.²⁷³ Fixed assets consisted of physical plant machinery, equipment, and real estate.²⁷⁴

150. Also reflected in the asset sale agreements for the Business Sales is the fact that the purchasers assumed certain liabilities of the respective Nortel Lines of Business.²⁷⁵ These assumed liabilities included contractual liabilities, royalty liabilities, warranty provisions, accrued vacation, product defect provisions, and net deferred revenue.²⁷⁶

151. The assumption of liabilities by a purchaser in the context of the Business Sales essentially constituted additional consideration provided by the Business Sales purchasers to the Nortel selling entities and should be reflected in the ultimate sale price of the assets. For allocation purposes, the assumed liabilities are therefore thought of as a class of assets with a fixed, negative value, which is then netted against the value allocable to each entity out of the gross value of the assets transferred.²⁷⁷

B. Valuation And Allocation Of The Net Tangible Asset Class

152. Mr. Huffard combined tangible assets and assumed liabilities together in the Net Tangible Assets class because tangible assets and assumed liabilities are valued and allocated in the same fashion – based on their recorded book value and ownership as shown in Nortel’s

²⁷³ Huffard Report ¶ 62.

²⁷⁴ See Huffard Report ¶ 62.

²⁷⁵ Huffard Report ¶ 63.

²⁷⁶ Huffard Report ¶ 63 & n.77.

²⁷⁷ Huffard Report ¶ 64.

financial statements.²⁷⁸ Book value represents the fair market value of that portion of the Business Sales proceeds attributable to Net Tangible Assets.²⁷⁹

153. Mr. Huffard's report includes detailed analyses of the values of monetary assets, inventory, and fixed assets sold in each Business Sale, as well as the value of the liabilities assumed by each purchaser.²⁸⁰

154. Once the book value of the monetary assets, inventory, and fixed assets is determined and netted against the value of the assumed liabilities, the total – Net Tangible Assets – is then allocated directly to the Nortel debtor that carried those tangible assets and assumed liabilities on its balance sheet.²⁸¹ Mr. Huffard allocated the values attributable to the Net Tangible Asset class based on the net book value recorded in the books and records of each Nortel seller as of the fourth quarter of 2009.²⁸²

155. The table below sets forth the resulting allocation of the Net Tangible Assets²⁸³:

²⁷⁸ Huffard Report ¶ 65.

²⁷⁹ Huffard Report ¶ 100.

²⁸⁰ Huffard Report ¶ 86.

²⁸¹ Huffard Report ¶ 100.

²⁸² Huffard Report ¶ 100.

²⁸³ Huffard Report ¶ 101.

BUSINESS SALES: NET TANGIBLE ASSETS									<i>\$ in millions</i>
Estate	CDMA	Enterprise	MEN	CVAS	GSM	MSS	Layer 4-7	Next Gen	Total
Canada	\$ 3	\$ 8	\$ 22	\$ (1)	\$ 4	\$ 2	\$ 0	\$ -	\$ 39
US	10	25	72	(1)	(15)	12	1	2	106
CALA	0	0	3	(0)	(1)	(0)	-	-	2
EMEA	-	7	10	14	(62)	3	0	-	(27)
APAC	(15)	9	(0)	(1)	(1)	12	-	-	4
Total	\$ (2)	\$ 49	\$ 107	\$ 12	\$ (75)	\$ 29	\$ 1	\$ 2	\$ 124

VII. SUMMARY OF EMEA DEBTORS' ALLOCATION POSITION

156. Application of the principles outlined above produces the following allocation of the proceeds of the Nortel Business Sales and Residual Patent Sale:

CONTRIBUTION APPROACH				<i>\$ in millions</i>
Total Allocation by Contribution Approach: Business Sale IP (Sale Specific) / Residual IP (1991-2006)				
	Canada	US	EMEA	Total
CDMA	15.8%	80.4%	3.8%	100.0%
Enterprise	20.2%	50.9%	29.0%	100.0%
MEN	23.7%	47.1%	29.2%	100.0%
CVAS	29.2%	41.9%	28.8%	100.0%
GSM	23.6%	66.3%	10.1%	100.0%
MSS	13.1%	42.6%	44.3%	100.0%
Layer 4-7	27.5%	50.7%	21.8%	100.0%
Next Gen	33.0%	53.6%	13.4%	100.0%
Residual IP	39.5%	42.9%	17.6%	100.0%
Total Allocation	31.9%	49.9%	18.2%	100.0%
Total Value	\$ 2,320	\$ 3,636	\$ 1,325	\$ 7,280

157. The EMEA Debtors respectfully submit that the asset sale proceeds should be allocated in accordance with the table above.

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IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION APPLICATION UNDER PART IV OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED.

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JOINT ADMINISTRATORS' PREHEARING
BRIEF REGARDING ALLOCATION OF THE
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